HOW TO RUN A SMALL BUSINESS

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SECOND EDITION

McGRAW-HILL BOOK COMPANY, INC.

NEW YORK TORONTO LONDON

1955

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Library of Congress Catalog Card Number: 55-11566.

PREFACE

The complexity of modern business operations is not confined to big business alone. Because successful business management today calls for a working knowledge of financing, taxes, accounting, insurance, law, office management, and promotion, know-how in a particular business line may fall short of insuring a profit-making venture.

As a small businessman, you may not have to be an expert in all of these fields. Nevertheless, you must be aware of them and have sufficient understanding to enable you to deal with the problems presented in these areas. They can determine the success or failure of your business.

How to Run a Small Business is intended as a practical guide to all the areas of required information for the small businessman in our present-day economy. It assumes that your business activities consume the major part of your time. Thus our purpose is to give you easy-to-read, pinpointed answers to your diverse problems. To do this, we have designed special check lists to be used as—

A quick summary of the various implications of a business situation
A reservoir of ideas that in the day-to-day pace of business you may easily overlook
A guide to the tax advantages and tax pitfalls of a business matter
Your insurance against (1) faulty memory, (2) failure to claim rights under the law, (3) unwitting or inadvertent assumption of risks or liabilities, (4) inexperience in a particular phase of your activity

In addition to these aids, a special supplement of tax ideas for businessmen is included. Today a book on business must be pointed to the ultimate goal of successful operations—net after taxes. With tax rates that go as high as 91 per cent, a $1.00 profit may only mean $.09 in your pocket. And you can rarely make a business decision without either increasing or decreasing your tax liabilities. The special supplement shows you ways to cut the taxes on your business profits.

There are some necessary precautions in using a guide of this type. Although it serves to give you the best kind of experience—eliminating much of your business operation that is based on hunch, intuition, and vague memory—it cannot be a substitute for the composite of intelligent vision and flexibility of mind that is summed up as business imagination. Rules like those expressed in this book are not the alternative to the creative business mind but the aids to that mind.

This book aims to free you of the labor of research others have done for you. Use it as a watchman to be sure no important details have been overlooked. Then you can be at liberty to use your own creative planning for a more successful business.

SYDNEY PRERAU

CONTENTS

HOW TO RUN A SMALL BUSINESS

WHY THIS BOOK IS IMPORTANT TO YOU

The major goal in business is making profits. But profits come as the result of the difficult job of blending many factors—to name just a few of them: taking quick action on business opportunities, careful planning of business moves, good accounting methods and control, proper tax planning and elections.

In these and other areas of business action, use this book as your advisor—for it is a collection of ideas and techniques on how to make money and a warning against the causes of business failures. But on the other hand, once you have become aware of a technique that calls for expert knowledge, don't hesitate to seek professional advice. An attorney or a CPA will know how best to fit that technique to the particular facts of your business.

This book is divided into two parts: the first, general aid to *all* small businessmen; the second to *particular* businesses. The nine chapters which follow deal with subjects that apply to all kinds of businesses:

1. How to Build for Profits
2. How Good Accounting and Other Records Can Help Control and Direct a Business
3. How to Avoid Frauds by Employees, Customers, and Others
4. How Good Tax Management Can Increase Your Net Profits
5. How Best to Handle Your Credit and Installment Sales
6. How to Finance Your Business
7. How to Plan the Best Insurance Program for Your Business
8. How to Buy an Established Business
9. Should Your Business Be a Proprietorship, Partnership, Corporation, or Some Other Form?

Since American business is composed of stores, plants, wholesalers, and those who run offices, you'll find the last four chapters to be the collection of ideas on—

10. How to Operate a Store Most Efficiently
11. How to Operate a Plant Profitably
12. How to Make Profits in Wholesaling
13. How to Operate a Business Office Most Efficiently

Of course, there are a great many other matters which are common to all kinds of businesses—how they buy, sell, inventory, price, and so many other things. It seemed best to put them into the chapters devoted to running a store, plant, wholesaling, or office. If you read all of the chapters, not only the one which is applicable to you, you will gain these other points. Or you can short-cut your job through the Table of Contents.

1. HOW TO BUILD FOR PROFITS

One approach toward greater profits is to know what causes so many business failures. That will also help you to understand what is needed to create profits in going businesses.

The first couple of years always gives the most difficulty in a small business. Our best information seems to give these facts. In retailing—

About 20 to 25 per cent of businesses never last over the first year
Pretty close to 20 per cent more never last the second year
10 per cent go out of business in the third year
Less than 20 per cent are in business at the end of the tenth year
Drug stores, grocery stores, and hardware stores have the shortest life

The life of small plants or wholesaling firms may be somewhat better. Perhaps 25 per cent last for 10 years.

Small-business mortality comes from changes of ownership and discontinuances. Discontinuances include those that have failed and those whose doors have been closed voluntarily by owners. Sometimes a proprietor discovers that the going is rougher than he anticipated. He is unable to get out from under before he suffers a material financial loss.

Often the successful owners have succeeded simply by having greater managerial ability. And, of course, there are always cases where small-business owners quit because of poor health or age.

What causes all the trouble? Half is due to bad financial management. That covers bad record keeping, inadequate costing, poor financing, bad credit granting, personal extravagances, and too much overhead.

Much of that would be cured with decent attention to the figure side of the business. Good accounting will always put red flags onto sloppy buying, markups, extravagant selling, extravagant service, or proration costs. Many who have quit because of inability to use or understand cost controls should never have attempted to operate businesses of their own.

What are the risks in small business?

If you know the risks in small business, you may be able to organize for profits. Let me here list the more important causes of failures.

Half of business trouble comes from internal difficulties. Too many failures are caused by a refusal to recognize cost keeping, ratio study, and statement

study (all of which we have tried to emphasize in Chap. 2) as the life line of small business.

You need to understand and use your figures if you hope to operate a successful business.

Some of the trouble is due to bad management or to employees who are incompetent, inexperienced, or neglectful. That may be reflected in poor promotion, poor selling, inferior product, or poor location. Or it may come in—

- Failure to create reserves in periods of earnings
- Bad credit policies or overexpansion or speculation
- Investment in undesirable or uneconomical property, causing high financing or carrying charges
- Unexpected financial difficulties due to improper financing, expensive floating of working debt, encroachments on working capital, or inventory accumulations
- Indiscreet contractual obligations such as—
  - Agreements against sales in certain areas or against sale of certain articles
  - Bad contracts with unions or competitors
  - Long-term leases based on sales or purchase contracts at high prices
  - Long-term sales contracts at too low a price

How can you plan to avoid failure of your business?

Understanding the failures due to poor selling is all-important. See Chaps. 10 and 11 for all the aids suggested in this book.

In some small businesses, failure has come because profits are too long deferred. You may have to plan diligently to do this kind of job:

- Overcome "buying resistance" to an entirely new store or unproved product. Time is required to develop the market; advertising, missionary work, etc., are necessary for buyer acceptance, and that may take too much time
- Overcome competition of other vendors, or resistance of many organizations who see in you a threat to their investments or jobs
- Overcome the inertia of society, and condition the people to the innovation you may be presenting
- Have enough working capital to permit you to age or season a product, as in natural seasoning of lumber or "natural drying" of fruit, fish, etc., where a basic stock must be built up before business can hit its normal stride. (The same risk, requiring intelligent planning, comes with any other business where time must elapse before a normal sales level can be reached)

In some businesses, failures are due to a capricious sales market. The best

example is the store created to sell a product heavily influenced by style. Troubles also come when—

Acceptance of styles and public demand depend on unpredictable public taste
Sales prices are depressed intermittently by dumping and similar gluts
Specialty businesses depend on public "crazes" and "crushes" that are unpredictable, or there is the manufacture or sale of similar articles that "take" at irregular intervals

Some businesses fail because they unnecessarily take the risk of keeping all their eggs in one basket. The sudden loss of the customer, the market, the source of supplies, the license, or the key individual may cause trouble. You may readily count on trouble if yours is a satellite business dependent on a single customer or small group of customers, or if you become dependent on—

A single supplier or small group of suppliers
A chemist or key individual who controls the process of production
A single sales outlet
A license

In some businesses, climate or weather is a primary and uncertain influence upon sales. You must know the market. Then you can intelligently arrange your working funds to see you through the difficulty. See Chaps. 10 and 11 for a lot of aids on that. Difficulties will often come in—

Businesses in farming, horticulture, agriculture, and livestock—both those which plant and harvest variable crops and also those which raise livestock
Industries that make products the demand for which varies with weather conditions (umbrellas, raincoats, etc.)
Resort hotels, furs, summer and seasonal clubs, open-air restaurants, theaters geared to the weather and season
Sales of beverages such as soft drinks
Industries in which deterioration or spoilage due to weather conditions is a material factor (some chemical industries and food industries)

Some failures are due to accidents and to unexpected events. Insurance (covered in Chap. 7) may include your loss, but it cannot take care of cases where your store, your plant, or your product may meet suddenly with public disapproval. That has often happened.

Your planning must assume the calamities that may occur. Then you can organize to meet them. For example—

You may develop unexpected loss of customers, and it may cost much to meet complaints and returns
Your supply of materials may change in quality or quantity. In one case several deteriorations in quality of a product, and consequent loss of

market, were caused by an undetected change in the quality of the water supply

Unforeseen personnel difficulties may arise, such as illness of a proprietor or inability to get employees because of market conditions, accidents, or occupational diseases

Location problems may be caused by movement of customers to other districts or changes in sources of supply

Some businesses are constantly subject to unfair and ruinous competition and practices. They would include the businesses that are so often subject to—

Price wars or secret rebates

Unfair labor practices or competitors

Labor pirating

Infringement of patents; theft of secret processes, copyrights, or trademarks; pirating

Some businesses do not follow general business prosperity. You invest in them knowing they have a business cycle of their own.

Some are likely to have to wait before the recovery phases of a cycle catch up with them. When business begins to show a decline, you find that their sales slow down. Volume drops more precipitately than in general business. Others that do not follow normal business practices are—

Those whose sales are to persons other than the ultimate consumer. Sales fall off sharply when demand for consumer goods declines relatively lightly. That is sometimes due to accumulated inventories available to meet the lessened demand without reordering from primary producers. When the inventories are low and the recovery phases begin, the reverse processes take place. A small increase in consumer demand sets off a hasty expansion by primary producers eager for speculative profits, while costs are still low.

Those selling products that have a long life, like durable goods. They are likely to have a profit cycle different from the general business cycle. Purchase of such goods can be deferred for relatively long periods. Consequently during bad times the production drops sharply. It stays at a very low level. When business improves and the recovery phases get under way, these durable-goods industries become exceedingly active. These are often called "prince or pauper" industries.

In some businesses, failure is due to group pressures. Examples would be—

Consumer leagues' pressure

Dictation from monopolistic groups (suppliers, customers, transporters, etc.)

Temperance groups

Sanctions by religious or other pressure groups

Organized labor pressures

Picketing or boycott

Gangster coercion

In some businesses, failure is due to physical interruptions or economic distress to others. An example is where a source of supply upon which you are dependent is temporarily and unexpectedly cut off or diminished.

Many businesses are subject to unavoidable loss due to political changes. Conditions may be changed by new government regulations; for example, tariffs, excessive hauling inspections, introduction of government competition into your business.

Finally, some businesses are deeply influenced by variable legislation. That covers the worries that come with prohibitions, local options, price-control legislation, unequal tax burdens (usually local, as a tax on chain stores), health laws, quarantines, police and fire laws, and injunctions or foreclosures. They also include—

Local option and other restrictive legislation that seesaws according to the group in power
Public controls of operating or selling conditions, etc.
Legislative control of wages, selling prices, terms, etc.
Relocation of industries, migrations, reclamation programs
Enforcement of local laws with oscillating rigidity and laxity

Planning to meet all risks in a small business requires much foresight.

If you know what causes death and decay of business organizations, then you can intelligently see what you must do to forestall trouble.

How do you build for profits?

Much of this book is concerned with your financial and cost control. This is your life line. Chapter 2 tells what good accounting control can give you.

Much is about the need of a fundamental change to eliminate wastes, thievery, shoplifting, and high costs (see Chap. 3).

And much is about the need to organize and operate in the more advantageous economic environment, as that concerns sales, markets, sources of capital and supplies, less labor dissatisfaction, greater employee productivity, less regulatory legislation. You should check all those in the index to find how this guide helps to solve your difficulties.

For example, assume your problem is wholly poor working capital. How to aid that is covered at length in this book in Chap. 6. Working-capital problems may have to be cured by drastic steps like—

Abandoning your policy of selling wholly on cash for selling exclusively on long-term credit, or vice versa
Arranging for a bank or other financial institution to finance your sales, when before your sales were restricted to the limits of your own ability to finance

Converting your retail business from credit and catch-and-collect system to a vigorous cash-and-carry or to a cut-rate business
Converting your business into a "mutualized" or "cooperativelike" business by making your customers profit sharers, investors, and in a measure, coowners
Having merchandise suppliers finance your business by means of cash, long-term credit, or profit-sharing arrangements, or by the use of the consignment system

How can you change sales and marketing policies to increase profits?

Sales and marketing changes may mean studies to include elimination of unprofitable lines, products, markets, or customers. Chapters 10, 11, and 12 may tell you the way that problem is best handled in your own type of business.

Sometimes the cure of difficulties takes full knowledge of the cost of distribution; only then can you coordinate sales and production. It often means adopting measures to reduce seasonal production, concentrate on most profitable lines, and reduce the variety and number of products marketed. Many other steps, after you know your cost of selling, are outlined in Chaps. 10, 11, and 12, particularly those to—

Determine the most economical sales distribution for your product (agents, jobbers, brokers, door-to-door selling, mail order, exclusive sales agencies, factory branches, etc.) and then formulate the best sales presentation and most useful promotion and advertising methods to aid that distribution
Adopt most effective promotion mediums after study of audience possibilities, merchandising opportunities, cost per unit of coverage, time factors, character and length of messages, useful life of the message, competition for attention, etc., as a result of which effective selling can be secured
Change customer services, customer credits, and other customer relations to enhance profits and eliminate abuses
Organize for most efficient, economical delivery methods by ascertaining the best process of shipping, for greatest convenience to customers, protection against damage or loss, speeding collections, suitability to size and weight of normal shipments, adaptability to shipping emergencies, adaptability to competitors' practices and customers' desires
Develop methods to teach consumers new uses of existing products; secure markets never before believed attainable for the product
Develop a whole new class of customers by such services to them as taking smaller orders or giving greater discounts, longer credit terms, premiums, generous return privileges, unusual guarantees, unusual deliveries, concessions on freight delivery charges, or unrestricted service after sale
Restyle or redesign the product and package to secure wider markets and

increase volume, or construct the product to get better protection in transit and make it more suitable to the purchaser and to needs of distributors. (Thus products often reach new markets never before attainable)

Change product design to make it clear, immediate, distinctive, visible on shelf and counter and in show window so as to secure sales not previously attainable

Change labeling to eliminate returns and complaints or make it more helpful to salespeople in procuring sales not previously attainable

All the plant changes are based on financial controls—cost studies of labor, materials, service, maintenance, and a hundred other elements.

Chapter 11 tells you how easily you can get that information.

What production factors should a small manufacturer review to increase profits?

How can a small manufacturing business get production changes to avoid troubles? Chapter 11 covers that in great detail. Perhaps it suggests radically different or new manufacturing processes. It also includes thinking about—

Adoption of all the controls of wastes, idle time, spoilages, maintenance, sales of by-products, employee frauds, and general change of thinking to one seeking full, intelligent control based upon accurate, speedy cost figures

Organizing for cost reduction in purchasing stores and supplies, other inventory controls, labor production, power, and all other possible sources

Machinery changes that make possible specialization of labor, use of unskilled labor for skilled labor, less labor, and more capital per unit of product, etc.

Adoption of real planning, scheduling, or routing techniques and sequences

Adoption of incentive plans that make changes in productivity of labor, resulting in increased efficiency, less deadwood, less labor turnover, less spoilage, and greater employee loyalty and effort

Securing control of quality through a system of standardization, inspection, etc.

Creation of better health and accident-prevention facilities to reduce turnover

Making in your own plant certain parts or assemblies formerly farmed out to others; or, vice versa, contracting out to others certain parts formerly made by you

What are the usual weak points in retail merchandising?

Twenty to twenty-five per cent of retail businesses never last a year. Here is a Department of Commerce list of things you must think about when you

start a store. It is also a fine check list to use in examining an established store. All of it is covered in great detail in Chap. 10.

The building and its location:

Is the site good for this type of store?
  Are there other similar stores nearby?
  Are most of the passers-by potential customers?
  Is the section zoned for commercial occupancy?
Is the space adequate? For present needs? For future needs?
Is the space too large? For present needs? For future needs?
Are the display windows suitable?
Is the front modern and attractive?
Is the entrance at grade level? Wide enough?
Is there storage space for reserve stock?
Is there a rear or side entrance for deliveries?
Is the construction sound? Attractive?
Will any major remodeling or alterations be necessary?
Are there enough electrical outlets for your purposes?
Are the plumbing facilities adequate?
Is there a satisfactory heating plant?
Are there any built-in fixtures or equipment you can use?

Rental terms:

Is the term of the lease long enough to protect you? Even if you make major alterations?
Are there provisions in the lease for cancellation? For subleasing? For renewal?
Does the lease provide for reimbursement for alterations?
Is the rent a fixed dollar amount? Or a percentage of sales?
Is the amount of the rent in proper proportion to the estimated sales?

Equipment and fixtures:

Have you determined your equipment needs? Your fixtures?
Have you planned for expansion and future additions to your equipment? To your fixtures? Can additions and replacements be easily and harmoniously made?
Have you held your purchase plans to the minimum? Without omitting any essential items?
Are your fixtures and equipment properly suited to the needs of your store? To the lines carried? To the customer appeal?
Is your investment in fixtures and equipment in proper proportion in your financial structure?
Are you going to pay for the equipment or fixtures on the installment plan? Have you decided the maximum monthly payment you can safely contract to make?

If buying fixtures and equipment as a part of the purchase of a going business: Are they a good buy? Is there a lien on them? Are they similar to the modern type you would select now? Have you checked to make sure they are in good condition? Do you need all of them in your operation?

Planning your stock:

Have you estimated how much your total stock should be?
Have you broken this estimate down into the major lines to be carried?
Has your stock selection been guided by an analysis of consumer preference in your community?
Have you set up a model stock assortment to follow in your buying?
Have you worked out your stock control plans to avoid overstocks, understocks, and out-of-stocks with your CPA?

Your source of supply:

Have you made arrangements with wholesalers? For each line of goods?
Have you decided what merchandise you will buy from manufacturers?
Are there any lines of goods which you can get the privilege of handling exclusively? What are the franchise arrangements?
Have you considered affiliating with a voluntary or cooperative group?
Have you planned to make your account more valuable by concentrating your buying?

Selecting your help:

What is the method of paying employees in the community?
What is the prevailing wage scale? What do you plan to pay?
Do you want to hire men, women, part-time, experienced, or inexperienced people?
Are satisfactory employees available locally?
Would it be advantageous or disadvantageous to hire someone now employed by a competitor?
What skills are necessary?
Will employees supply skills you lack?

Your accounting controls:

Have you planned a bookkeeping and reporting system with a local CPA?
Have you checked the index in this book to find all you need to get the best type of financial management?

Store policies:

Have you decided your service policy?
Are you going to deliver?
Are you going to sell for credit?
Are you going to operate on a self-service basis?

Do most of the other stores in the community offer full services or do they operate on a cash-and-carry or limited-service basis?

Is your best opportunity to offer more services, or to make an economy appeal?

What will be your returned goods policy?

Do you have the additional capital necessary to carry accounts receivable or to buy delivery equipment?

Have you considered store policy in selecting lines?

What lines do competitors carry?

What lines are lacking which customers would buy?

Do you have the capital and space to carry all the lines carried by competitors?

Do you have the capital and space to carry any lines not carried by competitors?

Have you considered the profit possibilities of the various lines?

Do you have the knowledge and experience necessary to handle the various lines?

Have you decided on your price policies?

Are you going to make a price appeal?

What price appeal do competitors use?

Are you going to compete on price, or on quality, or on service?

What price ranges would best appeal to most of the people in the community?

Have you decided on your store hours?

What hours do competitors remain open?

Would you attract trade by opening earlier? Remaining open later? Being open on Sundays or holidays?

Will you have the personnel to be open on these hours or days?

Have you decided on your promotion policy?

Are you going to do outside selling?

Are you going to advertise in the newspaper?

Are you going to rely on display windows to attract trade?

Are you going to do direct mail advertising?

Are you going to use radio advertising?

Your financial arrangements:

Have you made an estimate of the capital you will need?

How much will you invest in merchandise inventory?

How much will you invest in equipment?

How much will you invest in fixtures?

How much will you need to modernize?

How long will it be before the business will start making profits?

Have you funds to pay the operating expenses until the business pays its way?

Have you funds for the salary you will pay yourself during the period the business is getting started?

Have you figured out where you can get additional capital if it is needed?
Is there any reserve available for unexpected needs?

Estimate of sales and profits:

What are the sales you can reasonably plan to make the first month?
What are the sales you can reasonably plan to make the first 6 months?
What are the sales you can reasonably plan to make the first year?
What is the gross profit you can make on this volume of business?
Can you forecast the necessary expenses?

How can you use the tax laws for greater profits?

Chapter 4 tells you how good tax management can help profits. For example, any repairs to business property are allowed as tax deductions today. They cut your taxes. You can deduct any costs to keep property in an efficient operating condition, such as—

Recurring costs like painting, patching, plastering, decorating
Construction to meet safety requirements, to eliminate hazardous conditions for customers or employees, or temporary construction that has a short life
Replacement of worn parts of machinery
Alterations to meet changing conditions or attract customers or employees
Changes to correct mistakes in construction or installation or to repair for casualties like thefts, hurricanes, storms, etc.

You can get a deduction today for the cost of moving machinery from one place to another. Perhaps this is the time to move and take your losses.

The cost of resetting machinery pushed aside is a present deduction—it may be advisable to attend to the rearrangement now. Other important points are—

You can get rid of anything that you will not need later and get a full deduction for it now—that may be more profitable than waiting for a lower tax year to get tax aid in your replacements
It may pay to check your equipment now to find what sales or abandonments will result in reserves through tax savings
Immediate replacement of machinery available may give you many advantages, for example—
  New installations permit depreciation at the present high tax rates—this may mean a large tax saving
  It avoids arguments as to the amount of accelerated depreciation on old equipment used in overtime production, when new machinery will do the job without plant strain

If you have high-priced or excessive inventories, nothing prevents your immediately selling your excess inventory and taking your deduction. You can

settle commitments now, pay what you must, and get a deduction for the loss.

The net operating loss carry-over can be of vast importance in changing your current business operations.

If you have a loss this year, you may have a carry-back giving you a refund of your two prior years' taxes and a carry-forward cutting your taxes for the next five years. Here is how this works: The law says you apply this year's loss against the income of two years ago. Then, if part of the loss still remains, you apply the remainder—until it is used up—against the income of a year ago and the income of the next succeeding five years. See your CPA. He will show how you may get a quick refund of your prior years' taxes if you have suffered a loss this year.

Perhaps that suggests the following points about changes you might undertake to reorganize your business:

Business ventures which may result in possible losses may now be undertaken, if sound policies dictate, with the certainty of quick refunds of taxes previously paid. These taxes can often be recovered with sufficient speed to aid in the financing of the business loss.

Profitable business departments can be bought by a company losing money or with a carry-over with the certainty that part of the investment will be returned through reduced taxes on the operations.

A profitable business can acquire a losing business, if sound policy dictates, with a reasonable assurance that net losses created for the business will be paid for in part by refund of the prior year's taxes.

Study of the possibility of your taking losses this year rather than in later years becomes very important. A loss gives you the carry-back. Review possible abandonments, claims for obsolescence, loss of useful value. Possibly sell discarded equipment. Do not store equipment or worthless assets when you have a carry-back. You may not get it later.

Conversion of business operations may be undertaken with more assurance when you have a carry-back. Study the list of possible development costs and advertising costs which you may undertake in order to build up future earnings.

This may be a period to spend for—

- Extensive expenditures for research and business development
- Expenditures in the study of new markets and new products
- Quick settlement of expenses that will give you a deduction this year rather than in a later year
- Clearance of defective and obsolete inventory

2. HOW GOOD ACCOUNTING AND OTHER RECORDS CAN HELP CONTROL AND DIRECT A BUSINESS

Useful accounting records can be simple. They require little time to keep the successful small businessman well posted on the condition of his business.

Bad use of accounting controls is one reason so many small businesses fail. Some studies of small-business bankrupts show that almost one-third kept no records. Less than one-fourth kept adequate records.

A vast percentage of small business firms discontinue business within their first year or before reaching their second anniversary. Inadequate records are an important cause. In one check of 30 "failed" druggists, only two had ever attempted to prepare statements of profit and loss and balance sheets from the records maintained in their business. Three kept no records whatever. Others had notebooks in which they recorded only purchases and sales. Most of the "failed" druggists, although on the road to ruin for many months, were not aware of their ultimate failure until it arrived.

How to get good records

Don't try yourself. Call in a local certified public accountant

Tell him what you want. Tell him, too, that the U. S. Department of Commerce, many states, your trade association, and perhaps your suppliers have systems, standards, and guides that will help him

Let a CPA set you up. And get him to come in regularly to watch what is being done

Why the certified public accountant can help the businessman

Why use the CPA? Let me quote here from a booklet issued by the American Institute of Accountants:

> Running a successful business these days is a lot more complicated than it used to be. That goes for the small and medium-sized business as well as for the big concern.
>
> Costs are high. And as competition returns to normal, the job of maintaining the profit margin between costs and income will require a lot of business brains. At times it will take special handling and special skills.
>
> The paper work alone, much of it financial paper work, is often so enormous that one is reminded of the aircraft manufacturer who ruefully said he could always tell when a plane was finished—at the moment the plane and its paper work both weighed the same.
>
> When special skills are needed, the smaller-sized businessman is turning increasingly

to the accounting profession for practical help. The accounting profession, in step with the times, is providing more and more help in solving problems the average businessman faces.

Let's take some examples. . . .

Businessman Robinson said that he really ought to be doing all right. His kind of retailing wasn't very complicated. He knew what things cost, and he knew what it took to handle them: then he just had to make a reasonable markup, and he had a selling price. Still, somehow, there didn't seem to be as much margin as there ought to be. . . .

Robinson's certified public accountant, in the course of an audit which included a special analysis of the company's affairs, began to uncover some reasons for the trouble: hidden costs.

It was not Robinson's habit to buy stock out of town, for example, but he had been doing so quite frequently to fill special orders. That meant "now and then" freight bills which had been disappearing into overhead instead of being allocated to the cost of goods sold. The profit margin wasn't really what it seemed to be.

And another thing—Robinson maintained a crew of servicemen, whose area had been expanded to get business. Naturally it cost more to send the men farther away from home base; but these costs, too, were being absorbed—and not by the customers. In short, the special orders and the extra service trips looked profitable when sold or billed at the usual rates, with the usual margin. A careful analysis of the figures showed that they were not profitable—they were losing money.

The CPA helped Robinson set up his books so that he could make a proper charge for the special services to his customers. These charges didn't add much to any single order from any customer, but taken all together, they made a lot of difference to Robinson.

Now take a more complicated case—George Brown and his inventory.

A small wholesaler, Brown had been expanding gradually for ten years or so, but had never bothered to take a physical inventory—it didn't really seem necessary. Every year he estimated his opening and closing inventories at an even $5,000.

But Brown overlooked one fact. His inventory was growing as his business grew, and so, when he carelessly kept his estimate at $5,000 in his tax return, he was mistakenly including amounts which went into building up stocks under "cost of goods sold."

Finally he did take inventory and discovered—to his amazement—that goods on hand came to something like $52,000. His bookkeeper told him that he faced the prospect of an $18,000 tax bill! Reason: if he reported opening inventory at $5,000 and closing inventory at $52,000, for one year, the $47,000 difference—presumably—represented income that year.

In something of a panic, Brown sought the advice of a CPA. The CPA satisfied himself—and the Bureau of Internal Revenue—that no fraud had been involved, and arranged to file amended tax returns for previous years showing a more gradual growth of inventory and recomputing the actual cost of goods sold each year.

On this basis, with one year of off-setting losses, the total additional tax liability was cut down very substantially.

This particular story ended more or less happily, but if Brown had not discovered the discrepancy and reported it himself before the Internal Revenue agents did, and if he had not had the advice of a tax expert, he might have found it difficult to prove that he had not intended to defraud the government, and a penalty might have been assessed in addition to the tax. He decided that a regular audit by a CPA would be a very good idea.

Tom Brady was president of a small manufacturing company which made furniture —and farm wagons. The original business had been farm wagons entirely, when it was started by Brady's grandfather many years before. There was still some demand for the

wagons, and since they had always been a profitable item, the firm kept right on making them.

But in this case, too—for different reasons—profits were not what they should have been.

When his certified public accountant came in to make an annual audit, Brady complained that he didn't seem to be making as much money as he thought he should.

"It's going to be a bit difficult to trace your trouble from your books," the CPA said. "You don't keep your cost records separate for your different lines, and you probably have a loss somewhere that you don't know about. For example, how do you figure out what to charge for a farm wagon?"

"Well," Brady answered, "it's really a matter of history. We've always made a profit on the wagons, so when lumber goes up, or when wages go up, I add a reasonable amount to the price to cover the higher cost, and figure that should be about right."

But it wasn't as simple as that. When the main business of the firm had been making farm wagons, the prices were right to show a fair profit. But when the volume dropped off, the actual cost of making wagons went up considerably more than the increases in lumber and wages.

The thing Brady hadn't figured was a proper allocation of his overhead. Making only a few wagons on special order meant disrupting his regular schedules on furniture and took a lot more time and plant space per wagon than it had when they were in larger volume production. The wagons were also using up expensive materials which did not average out the same as the over-all increase in lumber costs for the whole factory.

So Brady was not making any money at all on wagons—he was losing money on every one he made.

But, as he said himself, he might have gone on doing it for years if he had not had the advice of a specialist in the analysis of costs.

Farm wagons, of course, are a specialty. Not many people make them these days. But a lot of small manufacturers do face similar problems when they make several different products, using the same basic raw materials, but selling in different markets to meet different demands. Under such circumstances, finding out the actual cost of each item—and so what its selling price should be—requires special record systems which take a lot of technical skill to install.

These three examples which have been given—all of them, incidentally, based on actual cases—are typical of problems which certified public accountants can help the small businessman to solve.

Hidden costs, special tax liabilities, unbalanced inventories, losses in one line eating up profits from another—all of these can create problems in any business, and the solution is not always apparent to the naked eye.

Every small businessman must be a specialist in several fields: he must know where to buy goods and materials, how to make or merchandise his products, what prices he can charge in the markets which are open to him, and when he must change his lines to suit his customers. In most cases, he doesn't have time to keep up to date on taxes, cost accounting, and efficient record keeping.

It is surprising, for example, how many businessmen pay more taxes than they really owe. And of course there are many others who fail to set aside funds to cover tax liabilities because they just don't know about them.

When it comes to these increasing complexities of paper work, more and more small businessmen are finding that it saves them time and money to turn to a specialist in that field—the certified public accountant.

What to get from your records—they should be more than mere bookkeeping

Plan your accounting system so that it gives you far more than good bookkeeping. Get from it a continuous analysis of your business—records that are

vital to intelligent planning and control of your business. What should you seek?

- Make sure the system is so constructed as to give the results of all operations clearly, quickly, and with full explanations of what has occurred
- Be certain that it permits quick comparison of accomplishments with the prior year's figures
- Create the whole system as a device to aid you. Make sure it quickly "red-flags" all variations from the ratios and standards you know to be essential for profits
- Design it to show periodically all possible employee frauds, wastes, errors, spoilage, and bad conditions that must be brought to your attention
- Make sure the system permits prompt filing of accurate reports and tax returns required by government
- Make sure it aids in the development of an efficient production and sales policy; for example, concentrating on the more profitable sales

Keep the system modern, economical, and useful. Be sure it results in the daily, weekly, monthly, and annual reports necessary to get an analysis of facts. Be sure it gives information swiftly, continuously, and accurately.

Insist that financial reports be out on schedule. Stale figures are useless.

Let's apply these principles to record keeping for a store. To operate at a maximum profit, it must keep total expense down and total margin up.

You cannot do that without some plan of operations. Here is where records enter the picture.

The record-keeping system is first designed to: determine net profit, net worth; get financial statements needed to obtain a credit rating; prepare income tax returns; account for social security taxes, withholding taxes, and unemployment insurance; get ready for excise taxes, state and city sales taxes.

But that is only the beginning of the job. It should guide and control operations throughout the year, by means of figures on sales, stocks, markups, and expenses. Good records and good operation go together. The experienced operator knows the value of records and how to use them to obtain a fair return on the capital risked. He watches sales, margins, stock, and controllable expense by records that tell him—

- Sales for the current day, week, month, or the year to date compared with those for the corresponding preceding period. This comparison will indicate whether the sales trend is up or down
- Costs, stocks, and margin ratios compared with planned ratios, with the preceding year's ratios, or with desirable standards to get a fair profit

You will find accounting aids to good management all through this book

Just a few of the aids are in this chapter. It seemed more appropriate to put the rest in other places; for example—

See Chapter

How good accounting records will stop employee plundering 3
Why good records are essential to good credit management 5
What kind of records you need to help you in your financing 6
What records you need to help you cut your tax costs 4
Records that are so essential to good store management 10
- How to buy
- How to figure price and markup
- How to control your inventories
- How to take inventories

Records that are so essential for good plant management 11
- How to fit good costing into the plant
- How to keep maintenance costs down
- How to keep accidents down
- How to buy
- How to inventory
- How to know the cost of your selling
- How to find your best market for profits
- How to keep records of what your promotion and selling efforts do

How records help wholesaling for profit 12
- How cost records are essential to find what and where to sell and how to service
- How inventories are controlled

Consider the simple problem of how you will run your mail promotion. That is covered in Chap. 12. Records are essential if you seek to reduce costs and improve results of future campaigns by—

- Elimination of unsuccessful copy
- Elimination of unsatisfactory names from active lists
- Information as to success or failure of—
  - Kinds of paper
  - Methods of reproduction
  - Cards vs. letters
  - Stamps vs. meter machines
  - Mailing dates
  - Premiums
- Analysis of costs to determine saturation points (diminishing returns)
- Comparison with previous campaigns
- Budgeting the expenditure
- Comparison with others

Or assume you have salesmen. Records are essential to do these kinds of jobs:

Ensure the direction of the salesman's activities through routing calls to be made weekly, budgeting his production, and budgeting his traveling expenses
Measure his worth by comparison with quota or budget and compare the relation of his cost to his income with his previous record
Check his expenses through careful scrutiny of the reasonableness of the expense item and comparison of cost to income produced

How to prepare useful operating statements

Your accounting system should give you (quickly) a monthly comparative profit-and-loss statement. It should tell you data for several years in parallel columns, to show the changes among items from year to year. Here is a comparative statement presented in a very condensed form:

Operating Profit and Loss for January, 1955 and 1954

	1955	1954	Increase or decrease, per cent	Per cent of total	
				1955	1954
Gross sales	$50,000	$40,000	25.0	102.0	102.0
Less: Returns and allowances	800	700	14.1	2.0	2.0
Net sales	49,200	39,300	25.0	100.0	100.0
Cost of goods sold	34,100	28,300	21.0	69.3	72.0
Gross profit	$15,100	$11,000	37.0	30.7	28.0
Operating expenses:					
Selling	$ 4,500	$ 3,200	41.0	9.1	8.1
Administrative and general	5,474	3,400	61.0	11.1	8.6
Financial	140	100	40.0	.3	.3
Total expenses	$10,115	$ 6,700	51.0	20.5	17.0
Net operating profit	$ 4,985	$ 4,300	16.0	10.2	11.0

A useful device on comparative profit-and-loss statements is that of percentage figures showing growth or decline in the various items making up the statement. These enable you to comprehend readily the trend of the sales, cost of goods, and expenses from one period to another. A comparative profit-and-loss statement also should show a percentage distribution based on net sales as 100 per cent.

The figures enable you to note the proportion or number of cents from each dollar of sales that go for goods purchased and for various expenses, and the amount remaining as operating income. Percentage figures of operating data are of great value in checking efficiency trends of a concern.

Each small businessman ordinarily prefers to determine for himself the amount of detail which he desires in the comparative profit-and-loss statement and the number of years for which he wants data. In the ordinary situation, it is not especially useful to carry a comparison of current data further back than the two previous fiscal periods. An exception to this might be where a bank or credit rating agency is examining the growth of a concern for the purpose of granting a loan or establishing a rating.

What your balance sheets can tell you

Your system should give you a monthly balance sheet. Comparing this with those of one or more previous dates enables you to see the amount and direction of changes in items on the statement. You can interpret the results of latest operations upon financial conditions.

The increase or decrease of a balance-sheet item from one period to the next, however, is more informative in most cases if it is stated in terms of the percentage increase or decrease instead of the change in number of dollars. For example, a statement that total assets increased $100,000 between 1954 and 1955 provides certain information. But the statement that the increase in total assets was 10 per cent has more meaning.

For this reason, a comparative balance sheet should show the asset, liability,

Condensed Comparative Balance Sheet for January 31, 1955 and 1954

	1955	1954	Increase or decrease, per cent	Per cent of total	
				1955	1954
Assets					
Current assets	$15,380	$12,200	26 0	43.8	43.0
Fixed assets	18,000	14,100	27.6	51.2	49.6
Other assets	1,750	2,100	16.6	5 0	7.4
Total assets	$35,130	$28,400	23 7	100 0	100 0
Liabilities and net worth					
Current liabilities	$ 6,000	$ 4,000	50.0	17.1	14.0
Fixed liabilities	10,000	8,000	25.0	28.5	28.1
Capital stock	10,000	10,000	00.0	28.5	35.2
Surplus	5,000	4,000	25 0	14 2	14 0
Reserves for contingencies	4,130	2,400	72.1	11 7	8 7
Total	$35,130	$28,400	23.7	100.0	100.0
Working capital	$ 9,380	$ 8,200	11.4		

and capital figures as of two or more dates ending successive fiscal periods. It should, in addition, show the percentage change in each of the items. As a small businessman, your primary interest is the amount of the item on the latest report and the percentage change from the last previous statement.

A comparative balance sheet also shows the percentage distribution of the total assets among the various individual assets, and percentage distribution of the total liabilities and net worth among the several items in those categories. The percentage distribution figures for two or more dates enable a small businessman to analyze his statement more readily for purposes of determining the nature of changes in financial status. They will reveal whether current assets have grown or decreased in proportion to total assets over several years in comparison with similar proportionate changes in current liabilities.

Comparison of three or four, or even more, years may be made depending upon the needs at a specific time.

How your financial and operating ratios can help you

A useful source of information for the small businessman is a method known as ratio analysis. This involves comparing one item with another on the balance sheet or on the operating statement, or comparing items selected from the two statements. Where two items from the balance sheet are compared, the resulting figure is called a financial ratio.

For example, the current ratio, that is, $\frac{\text{current assets}}{\text{current liabilities}}$, is a financial ratio.

When a ratio uses one item drawn from the operating statement it is called an operating ratio. It relates to some phase of the current operations. An example is the inventory-turnover ratio, $\frac{\text{cost of goods sold}}{\text{merchandise inventory}}$.

Current ratio. This is the most commonly used and perhaps the most significant ratio for indicating financial conditon. It shows the ratio or proportion of the current assets to current liabilities; for example:

$$\frac{\text{Current assets}}{\text{Current liabilities}} = \frac{\$15{,}380}{\$\ 6{,}000} = 2.56 \text{ current ratio}$$

In computing, prepaid expenses should be omitted from the current assets even though they are shown under that heading. Prepaid expenses usually cannot be turned into cash as can other current assets.

The current ratio also gives the amount of working capital—the excess of current assets over current liabilities. The working capital in the example above is the excess of $15,380 over $6,000, or $9,380. The working capital reflects the ability of a business to finance its current operations after allowing for payment of its current liabilities.

It is commonly agreed that the current or working-capital ratio for a store or a factory should ordinarily be at least 2. This means that current assets should be at least twice current liabilities. That provides $1 of extra current assets for each dollar needed to cover the current liabilities.

This 2:1 ratio is meant to be a safeguard to the business. A part of current assets may consist of slow merchandise not yet sold and of receivables which may be subject to discount for possible poor accounts.

A business which maintains current assets barely equal to its current liabilities will be in a weak financial condition if half or more of the current assets consist of merchandise and receivables. In an emergency requiring payment of all current debt, the merchandise and receivables would need to be sacrificed, or the business might find itself in the hands of its creditors.

A current ratio of less than 2 may be satisfactory in some situations. A ratio higher than 2 should be maintained where the current debt is of an extremely short-term or demand character.

Acid-test ratio. This ratio is similar to the current ratio but shows cash capacity more sensitively. It expresses the relation between the quick assets (cash, collectible receivables, and readily salable securities) and the current liabilities. The ratio is derived by dividing the quick assets by the current liabilities; for example:

$$\frac{\text{Quick assets}}{\text{Quick liabilities}} = \frac{\$7{,}350}{\$6{,}000} = 1.2 \text{ acid-test ratio}$$

Inventories, prepaid expenses, and longer-term investments are excluded from current assets in computing the acid-test ratio.

When this ratio is 1, a business is considered in a satisfactory liquid condition. That means that cash plus marketable securities and current receivables are equal to the current liabilities.

Unless there is a special reason for accumulating liquid funds, such as paying of maturing debts, it is well for management to examine the cash receivables periodically. Perhaps investment of some surplus cash in income securities or expanding operations is called for, in order to put its liquid funds to work.

Ratio of inventory to current assets. This percentage ratio is obtained by dividing the inventory figure by the total current assets; for example:

$$\frac{\text{Inventory}}{\text{Current assets}} = \frac{\$\ 8{,}000}{\$15{,}380} = 52 \text{ per cent}$$

This percentage serves as a check upon overinvestment of current funds in inventory. You may use it, along with the inventory-turnover ratio, to determine a rational inventory policy in your business.

Ratio of liabilities to net worth. This ratio reveals the relative proportions

of business ownership belonging to all types of creditors, on the one hand, and to the proprietor, on the other; for example:

$$\frac{\text{Liabilities}}{\text{Net worth}} = \frac{\$16{,}000}{\$19{,}130} = 83 \text{ per cent}$$

When computed for several successive business periods, this ratio reveals the trend in proportion of debt to ownership. It shows whether a larger share of business assets is being held by the owner, or whether business assets are being acquired through borrowing from creditors.

In general, it is always preferable that business operations from year to year result in an increased proportion of ownership in the hands of the proprietor. This rule is subject to qualification. It may be changed as a result of temporary or periodic borrowing on favorable terms to meet specific situations.

Whenever a business retires some or all of its debt, this debt-to-net-worth ratio is reduced. When, however, a concern finds itself sufficiently established in its field, it may prefer to increase its debt financing for expansion purposes. Then the liabilities will again bulk larger in relation to net worth. This situation may be particularly desirable if: equity capital is unavailable; surplus earnings are insufficient; and borrowing can be done at favorable interest rates, leaving a considerable portion of net earnings for stockholders.

Inventory-turnover ratio. This ratio has significance because of its usefulness in controlling inventories.

The smaller the stock of merchandise a business can operate on, and still meet all customers' demands, the smaller will be its requirements for working capital.

This policy also reduces the storage space for merchandise and the expense for insuring goods in stock.

This ratio, therefore, is designed to enable a business manager to measure his efficiency in purchasing, handling, and moving his stock in trade.

Merchandise turnover is computed when the cost of the goods sold during a fiscal period is divided by the average of the opening and closing inventories. This gives the number of times the average inventory has been "turned" during a period. For example, if the cost of goods were $120,000 and the average of the initial and ending inventories were $20,000, the merchandise inventory turnover would be shown thus:

$$\frac{\text{Cost of goods sold}}{\text{Merchandise inventory}} = \frac{\$120{,}000}{\$\ 20{,}000} = 6 \text{ times turned}$$

The average age of the stock would be 2 months. This does not mean that every part of the stock has been sold and new stock purchased six separate times during the fiscal year. It does mean that the equivalent of this has been

accomplished in terms of the total goods handled during a 12-month period.

It is obvious that some parts of inventory stocks may not have been turned at all. Others would have been turned more than six times.

The rate of merchandise turnover varies greatly with different types of businesses and with different degrees of management efficiency in terms of purchasing, inventory, and sales technique.

A new business should keep a record of this ratio on its operations for each fiscal period, preferably 3 or 6 months. It should watch closely changes in the turnover rate. Then it can soon determine what the typical inventory turnover rate is and whether it can be improved by careful management.

In the ordinary merchandising concern, the inventory turnover may be figured for all the merchandise combined. Or a separate rate of turnover may be figured by departments on main types of merchandise. The latter is desirable. It enables management to spot slow-moving goods that should either be pushed more aggressively by sales technique or discontinued entirely.

For this reason, every business manager engaged in distributing a variety of products should keep informed on the turnover trends. He should figure turnover ratios for the main commodity groups.

In a manufacturing concern, inventories normally consist of raw materials, goods in process, and finished products. It is necessary here for the turnover rate to be calculated for each of these classes of goods if the ratio is to have any meaning for management.

A lower-than-average inventory-turnover ratio is usually an unfavorable sign. The stock may contain so much old merchandise that sales of new goods are slowed up.

An extremely high inventory-turnover ratio may sometimes be attained by buying in quantities so small that the best prices are not obtained. It may also be gained by taking excessive markdowns.

Ratio of net sales to receivables. A valuable index of collections is the ratio of net sales for period to the amount of unpaid accounts and notes receivable at the end of that period. For example, if a company had net sales of $49,200 and total receivables of $5,850, the ratio of sales to receivables would be shown thus:

$$\frac{\text{Net sales}}{\text{Receivables}} = \frac{\$49{,}200}{\$\ 5{,}850} = 8.4$$

This means that annual rate of sales is about eight times the amount of receivables on hand, or that the average period represented by unpaid accounts and notes receivable is one-eighth of a year's sales, or about 40 days' sales volume.

This ratio is most valuable in a concern which makes sales exclusively on credit.

In companies which do a cash, as well as a credit, business, this ratio of receivables should be calculated in relation only to the portion of the sales handled on credit.

In situations of expanding receivables the manager should have before him either an annual or quarterly ratio on sales turnover or receivables.

Ratio of net profit to net sales. This is one of the more significant ratios, showing the number of cents of profit for each dollar of sales. This percentage reflects the efficiency of operation in terms of expense control as well as efficiency in purchasing goods handled by the business. The ratio is figured by dividing the net profit by the net sales; for example:

$$\frac{\text{Net profit}}{\text{Net sales}} = \frac{\$\ 4{,}810}{\$49{,}200} = 9.8 \text{ per cent}$$

The variation in net profit per dollar of sales presents a situation requiring close study by management of all factors in the business. Comparison of the operating statements for the last several operating periods affords a basis for detailed analysis of factors contributing to profits.

This ratio, coupled with the dollar sales volume, is the real measure of store efficiency.

A 2 per cent net profit on sales of $100,000 is better than a 5 per cent profit on sales of $30,000.

Since the ratio expresses the difference between the *gross-margin percentage* and the *expense percentage,* obviously either a high markup or a low expense will combine to produce a high net-profit ratio.

Bear in mind, therefore, that a high markup may be depriving you of sales volume because your prices are too high.

A too-low expense ratio, on the other hand, might mean that you are not spending enough for advertising, promotion, care of stock, or selling to produce the sales volume that could be obtained at your location.

Compare your ratios with others carefully

When your individual amounts are expressed as ratios to sales, several comparisons are possible. Current ratios may be compared, for instance, with those of the preceding year, or with those of similar businesses. Your wholesaler or trade association, too, may be able to give some assistance. They have contacts with a large number of small businesses.

Be very careful, however, when comparing your ratios with standards based on national or broad group averages. They include a diversity of businesses, and individual variations may be great.

Get a comparison of your figures so as to show the difference in net profit

between your profit-and-loss statement and the standard. The next step is to analyze the reasons for variations.

First, the purchasing, pricing, and selling plan should be thoroughly examined to discover why the gross margin is low. Next, the individual expense items should be examined with a view to taking corrective steps.

Often there are sound reasons why the ratios for an individual business vary from the standard ratios.

A high *gross-margin ratio* may result from buying at lower prices or selling at higher prices. Thus, a high gross-margin ratio and a low sales volume indicate the possibility of gaining more sales by reducing the margin. Lower selling prices or better merchandise values might attract more customers and increase both volume and net profits.

A low gross-margin ratio may be caused by paying more for goods, or by intentionally selling at a lower price. If greater sales volume and reduced operating expense result, the lower price policy is certainly more profitable.

Profitable stores obtain a higher-than-average gross-margin ratio and have a lower-than-average operating-expense ratio.

A high *total-expense ratio,* if accompanied by a high gross-margin ratio and satisfactory sales volume, is not objectionable. It might, for example, indicate that you are emphasizing the merchandise that offers a high margin and requires considerable handling or processing. Usually, however, a high total-expense ratio is caused by poor control over expense items. In other words, wages, supplies, and all other costs are higher than average.

Ordinarily a higher-than-average *wage ratio* is a danger sign. It may mean that labor is not being used efficiently, that the store is not properly arranged, that too much service is given for the markup obtained, or that there are too many employees.

A high wage ratio may indicate a policy of obtaining sales by providing more or better clerk service, which is offset by smaller expenditures for rent, fixtures, or advertising. The success of this plan can be determined by studying the sales volume, the gross margin, and the net profit. With a high gross-margin ratio, a high wage ratio may signify that emphasis is placed on high-markup goods requiring more handling and sales effort.

A low wage ratio is usually evidence of capable management. Generally, it is accompanied by better-than-average gross-margin, net-profit, and inventory-turnover ratios. If the sales volume is unsatisfactory, the low ratio may mean that not enough workers are employed, or that more efficient employees are needed.

Higher-than-standard ratios for expense items other than those already covered usually indicate an opportunity for expense reduction.

A cash-shortage or coverage (surplus) ratio of any significant amount, for

example, points to improper safeguarding of the cash, or negligence on the part of employees in keeping a strict account of cash.

A high depreciation figure might mean that the amount of fixtures and equipment being carried is too heavy for the volume of business.

A high miscellaneous-expense ratio usually indicates lack of control on such expenditures.

Heat, light, power, and water, however, like rent, can be controlled only at the start. Once the building is occupied these facilities must be supplied adequately, or sales will suffer.

Effective advertising yields more sales at a profit. The advertising ratio will automatically indicate a gain in sales, as they should expand along with additional expenditures for advertising. The gross-margin ratio should also be watched as regards the profit factor of a greater sales volume, for the increase should not consist only of low-margin goods.

Where you can get standard ratios with which to compare yours

It is important to make careful comparison of financial statements and ratios for a current business period with the same statements and ratios of previous periods. That comparison determines trends, weak points, and needed improvements.

Perhaps, too, you can compare your data with those of other businesses in the same line of activity and of approximately the same size. It is frequently possible to get coded comparative data for a number of concerns through trade associations and similar organizations. A necessary safeguard in making comparisons is that the businesses whose figures are used should have a standard or substantially uniform system of accounts. Otherwise a comparison with an individual concern having different accounting forms would be entirely misleading.

How do you get the data?

- When a concern becomes well enough established to have membership in a trade organization, it usually will have no difficulty in finding sources of such comparative data for other business units in its field of activity
- Tables regularly prepared by organizations like Dun & Bradstreet of New York (write them) may be used to good advantage. They determine an individual company's operating position in comparison with that of a large number of concerns
- Figures for certain trade lines may be had in a number of the Inquiry Reference Service leaflets of the U. S. Department of Commerce. Available copies of these leaflets may be had gratis by request directed to the nearest field office of the Department. (Check your telephone directory for address of nearest office)

How a budget can aid you in efficient management

Budgeting is an important tool for small business. It ensures considered planning before acting (by acquiring knowledge of the business) and using foresight as well as hindsight.

Budgets give you a yardstick with which to check results against expectations and estimates. They coordinate all the activities of the business. They make for the most effective use of your resources with minimum costs. Budgets are an aid to efficient management in these ways:

Reducing waste, since money is to be spent only for purposes carefully considered in advance

Fixing responsibility, since all participate directly in formulating budgets covering their activities

Restraining unwise expansion. Each undertaking is based on cold facts before commitments are made rather than on overenthusiasm and loose thinking

Establishing a proper relationship between income and expense. While a budget guides the expenditure of money to make money, it also acts as a definite check against the undue mortgaging of future income

Giving the opportunity, when actual results are checked periodically, to concentrate on the weak spots showing need of attention

Talk with your CPA about how to prepare your budget. He'll show you how to do it; how to limit the length of time to be budgeted according to your ability to forecast sales and costs. Then go ahead this way:

Assign practical people who are in charge of any part of your business to prepare budgets. Their concrete experience is invaluable. For example, the salespeople in direct contact with customers are best fitted to determine what they can foresee after careful analysis of their accounts and available business. The concentrated study and attention required of them to prepare the budgets force them to use their own valuable experience. Then they can, and logically should, assume the responsibility for completion and performance.

Have your bookkeeping people cooperate only to furnish the past year's experience in detail to serve as a basis for the new figures and any other data required to enable a practical businessman to review past performance and fix his goal. But the completion should not be laid upon the doorstep of accountants. They are capable of assembling the material submitted and supplying the figures on performance, but no more.

Give the budget a painstaking review. Without it, the budget may not conform to your plans for the business. Give the budget the stimulus of your goals. But be sufficiently temperate to bring it within measurable accomplishment.

If you have a budget, make sure you accompany it with controls of operations. That means systems to discover and curb unfavorable departures from budgetary plan. Certainly you want accounting reports comparing the actual results for each month of each activity with budget estimates. Also you probably need to do this:

Get accounting breakdowns that reveal and assign the reasons for any variations from budgets
Hold your people to strict accountability for variations
Periodically review variations and trends indicated to determine possible need of modification of parts of the budget
Take corrective measures courageously and quickly

How long should you keep records?

Preserving some records is essential. You must have what you need if you ever get into litigation, claims, or disputes. In addition, you should maintain necessary records for possible government investigation.

Your CPA will explain that to you. Good businessmen keep some records permanently to help work out long-range policies. In doing that, the use of your own experience records is needed—

To show the changes in the organization, sales, and costs of the business
To show changes in sources of materials, suppliers, customers, and consumer demand
To show changes in the attitude of competitors, the general public, and employees toward the business
To preserve the lessons learned during all the firm's history for future use

Why you should keep your records on your natural business year

A natural business year for your record keeping has many advantages. Financial conditions can be most accurately ascertained. Smaller inventories make for fewer errors in inventory valuations; results of operations can be most accurately determined—inventory inaccuracies in count and valuations are largely eliminated. Other important advantages are—

Inventory work is easier (more people may be available; they do not need to hurry so much; greater accuracy is bound to result)
Cash position is stronger
Credit statements are made at most favorable point; most liabilities will have been liquidated
Income-tax determination is more accurate, because results of operations are most accurate, and there is less stress of business at the time of making return

Auditing by Certified Public Accountants is less costly and more promptly done. CPA's are busiest at the end of the calendar year. Consequently, fees are higher. Verification of inventories and accounts receivable are easier at the end of natural business year and hence less costly. Less business pressure on CPA's during the year allows them to be more comprehensive and constructive

Select a 12-month period fitting your enterprise. It may or may not coincide with the calendar year. Generally you should close your year: when inventories are at their lowest ebb; when you have the strongest position; when your accounts receivable have been largely collected.

3. HOW TO AVOID FRAUDS BY EMPLOYEES, CUSTOMERS, AND OTHERS

The bonding companies (which pay out for only 5 per cent of the 500 million American business losses because of employee thefts) will tell you this: the average employee who regards his bosses' money as his own pork barrel is pretty generally your next-door neighbor.

From all appearances he is a decent citizen, bringing up his family in a normal manner. He has held his job for nearly 10 years. He is highly regarded by the firm he is looting, even though an average of 3 to 5 years elapses before he is caught stealing. When he first begins "embezzling," the employee would be horrified at the use of that term. He is merely "borrowing," with every intention of paying back.

What, then, makes him leave the normal road and become an embezzler? There are many reasons. Experts tell us gambling, extravagant living, and undesirable associates are most to blame. But we have known lots of other causes—improvident investments, severe illness of a member of the family, unfortunate outside business activity, and a hundred others.

How employees steal

To complete a list of all the ways used to steal is impossible. We learn a new one from a smart crook each day. But it is possible to put down the most used tricks:

- Plugging the petty-cash box with false vouchers to cover thefts
- Pocketing cash paid by customers across the counter or in sales on the road
- Stealing money sent in by mail or "forgetting" to enter cash sent in by a customer as payment
- Creating false bills from nonexistent vendors to secure payment for materials or services not delivered—then cashing the check. (This favorite method of employee pilfering reached grand larceny dimensions in a case we had a year or so ago. We once knew a $60-a-week voucher clerk to pile up a terrific shortage. The method was simple. Bills were made out on the billheads of nonexistent companies. When the checks were drawn, the cashier deposited them in accounts of the fictitious companies, using rubber-stamp endorsements. Then he withdrew the money. When a check he made out was questioned, he disappeared, and the fireworks started.)

Paying out salaries to nonexistent, discharged, or dead employees
Alteration of legitimate creditors' bills to get a new or added payment, which is then cashed by the cheater; or raising bills after they have been paid to get another check to be cashed
Sending goods to an imaginary customer and then selling the materials; or reducing the amount entered as the customer's bill in books, then keeping the difference when the customer pays
Kickbacks, split commissions, and other splittings with suppliers of merchandise and similar deals with customers to give them a favored position—even not billing them for what they received
Making all sorts of adjustments and write-offs of customers' accounts, sometimes in cahoots with the customers. (A good example of this is the fraud involving the adjustment manager of a store. He started by putting through fictitious returns to cover alleged costs he was paying. The amounts were for the most part under $10. It was more difficult to detect them because they were so small. The total theft reached over $150,000 before he was finally apprehended.)
Selling business property (by-products, fixtures, machinery, and automobiles, or even investments) and withholding the proceeds
Direct theft of material from the supply rooms or a store
Raising the amount on checks given the employee for a legitimate purpose, then destroying the vouchers when returned by the bank
Purloining stamps, often in large quantities, charging them to legitimate expense—then selling them in the black market found in most cities. (The purchase of postage stamps offers a convenient means for misappropriation of funds. One of our cases concerned an officer who personally signed a check voucher for $225 each month. He received a certified check payable to the postmaster. Upon inquiry at the bulk postage window at the post office, we found that he purchased rolls of 3-cent stamps. We caught up with the theft because we found that the stamps were not delivered to the company. Eventually we found they were sold in the black market. This procedure was followed for at least 5 years before it was uncovered. At $225 a month the theft was $13,500.)
Lapping cash—using receipts of today to cover up yesterday's embezzlements, until the employee is hopelessly involved

Thefts are often encouraged by tried relationships. The saddest frauds are those that come when a lot of money is stolen by trusted, old employees. I remember two cases: one a bookkeeper who had been with a publisher 28 years, the other a cashier with a retail furniture house for 30 years, before the thefts were discovered.

One we caught because some of us could not understand her reluctance to let a substitute take over her work during any vacations or illnesses. We became certain that this was based on fear of detection of fraud.

The other we caught because he always had night work to do. Some of us

are experienced enough to know that arrears in work may be caused by frantic jugglings to cover up.

Overintimacy sometimes invites collusion. It is essential to rotate employees now and then. "Trusted old people" cause more grief than the ones you don't trust.

All employees trusted with valuables should be bonded. If you do not take this precaution, you miss a valuable restraint. Bonding companies probably reduce frauds by 50 per cent.

Sometimes the hiring system goes wrong. It is best to engage employees through the personnel office rather than directly through shop foremen. That obviates "kickback" arrangements.

The leak in one case was valuable dies and tools that were being stolen out of a storeroom. The clerk hired, and the foreman hiring, were in cahoots. The same hiring system once found a company paying for nonexistent laborers. That means you have to do two things: where practicable, have mechanical time-recording devices to avoid "faking" time spent on the job; in addition, make an occasional independent check to see that all employees on the payroll really exist and are at work.

Internal checks that will help stop plundering

One of the ways to rob an unsuspecting employer is permitted when there is no internal check. All decent systems affecting cash or collections must be set up so that at least one person checks the work of another by using a different procedure.

I knew an office manager who opened the mail and made entries in the books. The office was a small one. The manager had been with the company for 15 years. He was a "trusted employee," a highly respected member of the community, and married with two children. The company's profits had been advancing slowly but steadily over the years. Unaccountably, the profits fell off. He was eventually caught because CPA's asked the owner of the business to personally approve a lot of accounts written off. The "trusted employee" had been pilfering money sent in by mail, instead of crediting the customer. The amounts involved were substantial before his employers caught up with him. The excuse: he needed more money for the children and to keep his place in the social life of the community.

It is easy to avoid that kind of fraud when the work of the office or the plant is set up to secure full inside internal check of one person by another; for example, methods in which—

One employee records a sale, but another charges the customer's account
One employee receives the collection, but another records the credit to the customer

One employee handles the cash, but another keeps the cash ledger account
One employee accepts an order, but another receives the goods
One employee approves the invoices for payment, but another issues the check
One employee makes up the payroll, but another issues pay checks and takes receipts

Be on guard for cash frauds—they are most common

Among the stupid acts of businessmen that have caused great grief when the thief finally confessed are these:

Careless signing of checks in advance of seeing bills just because you are "sure of the honesty of the bookkeeper"—that always invites fraud
Not getting a full review by yourself or a CPA of your bank accounts; not guarding against borrowing from one account to cover a shortage in another. To do that, you have to make sure your method of inquiry questions all transfers between your banks, particularly those at the end of the month. Usually the deposit, but not the withdrawal, may be recorded in the current month. (I saw a dishonest insurance agent run up a loss of $100,000 by switches of that sort.)
Using a till or cashbox instead of a modern register. The use of a cash box sacrifices all our desirable control features. Clerks have an easy time pocketing change unless the system protects the employer
Careless recordings of cash transactions. These are usually the beginning of shortages, whether by design or otherwise
Making "pay-outs" from receipts. Be sure you promptly deposit receipts intact in the bank
Not maintaining a petty-cash working fund, but using some other method. Make the cashier account for funds regularly
Not guarding vigilantly against unauthorized conversion of assets or assignments
Not prenumbering checks, requisitions, sales slips, and all like forms—and then making sure that all are accounted for and that none is used in an unauthorized manner
Not maintaining a follow-up on accounts that have been written off, to be sure that recoveries are properly accounted for

These are only the beginning steps to avoid fraud by people who handle cash. Experts sometimes use the following list of devices to ensure safety of cash:

Segregate the person handling cash and operations from the rest of the office
Provide adequate safe room; make certain that the safes are modern, burglarproof, and fireproof; permit only authorized persons to know the combinations; change the combinations periodically

Make use of the protection given by mechanical equipment—cash registers, analysis machines, autographic registers, check registers, automatic cashiers, paying machines, change-making machines
Make sure that the cashiers are required to give a full receipt for all funds taken in
Educate the payer of funds to get a receipt for proper credit of his payment
See that the cashier registers funds immediately upon receipt
If the registry is by a duplicate receipt, number it serially so as to control it fully
Make sure to place cashiers under bond
Have independent persons in office or have CPA's balance the cashier's funds and salespeople's registers
See that the cashier does not make disbursements from receipts; an imprest fund is usually more advisable
See that the cashier, if he receives money on charge accounts, does not have access to the ledgers
Make sure that the person making deposits is protected and bonded. Be certain that the firm has full insurance to cover highway robbery. Make use of the most accessible bank

Steps to take to avoid stealing of mail receipts

Mail openers have many opportunities to steal money or stamps. The process is usual where the mail is not opened under systems that recognize all the trouble such as we have had. Actual cases of fraud have taught us that it is necessary to do this:

Open the mail under competent supervision away from other people
Sort it immediately; fasten all papers and mailing documents together with cash or checks received
Place coin or stamps received in envelopes to prevent loss
Follow up carefully all complaints that cash was sent but not received; use the facilities of the post office in investigating such complaints—they do a competent job
Find out whether a modern registering machine, which creates a cash record and registers the customer's remittance documents, would be an economy and a protective device
Make check indorsing only "for deposit" and make it simultaneous with cash recording
Have entry into bookkeeping record done, if possible, by someone other than the mail openers. Then insist both people prove cash-receipts books daily with entries in customers' ledgers

Let me tell you one story of how the post office helped us catch up with a crook. He took half the incoming cash on orders and destroyed the orders. He forgot that complaints might come direct to the boss rather than to his

friends. They did. We turned the case over to the post office. They knew exactly what to do. They planted a couple of pieces of mail with cash in the regular incoming sack. From there on, the clerks were busy confessing.

To avoid trouble we usually segregate the cash and customer's order at once when received. Then we deposit the cash and furnish other clerks only with a record of what has come from the customers. I once knew of a case where the same clerk opened the mail, entered the customer's record, and entered the cash book. It was a cinch for her to write off a lot of small customers' accounts for noncollection (she actually kept the cash). We might never have caught her except for this: a CPA's wife sent in her cash to settle on a book she ordered. The clerk stupidly kept it and wrote off the amount. And the auditor was amazed to find his own name in the write-offs.

How to stop the most common thievery—from petty cash

Thefts from petty cash are the best known methods of employee larceny.

This is the way we caught up with Helen G. Originally she got into her taking ways because she needed money for some kind of operation that could not be discussed in the open. When I met her, Helen was the cashier in a printing plant, paying out all sorts of money upon slips bearing approval. That meant she furnished the cash for traveling, for discharged employees who were paid on the spot, for sundry supplies, and for a lot of small costs that were part of the daily routine. Helen's methods were simple. She knew she had to have a voucher countersigned by some brass hat for each penny she gave out. Why not, she reasoned, do this: when the bigwig made the slip out in pencil, just raise the amount moderately. When that didn't give her enough money, she just got out one of the old slips she had paid last year, changed the date, and reused it. We caught up with her only because she forgot that one official was off on a long trip when she let his last year's voucher go into her current payment file. But before we did, she had a merry 2 years of juggling.

From there on it was easy to get the head of the company to change over to an effective control of petty cash. That meant that we had only to get his approval to four simple steps—the ones for which auditors always plead, to stop Helen and her brand:

1. Require that any request for payment from the petty cash be made out in ink to prevent forgery and reuse
2. Insist that it be supported by invoices or receipts in every possible case and be approved by some competent official
3. Mutilate the petty-cash voucher after it has been paid, showing the date of payment, to prevent reuse
4. Take the vouchers away from the control of the cashier—or else you invite easy pickings

Common errors made in handling checks

A very usual fraud begins with permitting too free use of checks. We had a company president once who signed all checks before making a trip. In addition, he permitted the same clerk to balance the account. He made it easy for that person to carry off a lot of money. And he did. But there are many other stupid acts by otherwise sound businessmen; for example—

They forget that once in a while someone ought to make certain that vendors' names and indorsements are in accord with vouchers or invoices. If they don't, the clerk can easily pay a friend or ally twice as much as the vendor's bill, permitting him to settle with the vendor. I saw that done twice. The cashier paid the purchasing agent $100 for a $50 bill, and then the latter settled with the vendor. It was a cinch.

They sometimes permit checks to be issued to cash or bearer. That invites trouble. It is easy for the clerk to pay a fraction of the amount for your legitimate bill.

They neglect to observe this simple routine: have checks numerically printed; retain all voided checks; route checks paid and returned by the bank to a clerk other than the issuing one; have the bank reconciliation made by a disinterested person. That catches frauds by forgery, when a clerk signs a check and could get away with it.

They fail to consider the advisability of requiring more than one signature on a check; making sure checks are signed by one who thoroughly audits vouchers; and seeing that he studies the voucher or invoice to make sure to avoid forgery. That eliminates a lot of trouble, particularly against clerks who: use false invoices; reuse old invoices; raise totals of invoices in cahoots with vendors.

Losses that come from poor customer relationships

A great deal of loss is the result of poor relations between employees and customers. For example, we had the following occur:

Credit references of customers were occasionally faked to pave the way for improper transactions

Clerks sold one quality of goods and delivered another—inferior stuff. That gave an opportunity for "adjustments" that did not find their way into the accounts

Improper "kickbacks," split commissions, and like arrangements all benefited some person at the expense of the business

Clerks charged for something they should not charge for. (Take the case of B. G., the repairman in a jewelry store. It was the store's practice to do a reasonable amount of repair work for its customers without charge. Or, at least, that was the manager's intention. The repairman had other ideas.

He charged the customers and pocketed the collections. This worked so well that he branched out. On repairs for which the store usually charged, B. G. "upped" the charge and kept the difference. A casual remark by a regular customer caused the manager to investigate. It was not possible to determine the exact amount of the misappropriation, but a good guess placed it at about $8,000. The amount of customer goodwill that was lost could not be computed.)

Outside men collecting cash from customers simply reported the customer did not pay. (We once caught that by investigating carefully all instances in which the customer indicated that a salesman had already been paid and following carefully failure of customers to pay accounts billed on orders taken by salesmen. One case concerned A. D. His employer was well aware of the danger of having road salesmen make cash collections. His salesmen had to make up all sales slips in triplicate. The original went to the customer as his receipt. The duplicates were mailed to the office daily. The third copies were totaled and turned in weekly with the cash collected. But A. D.'s wife couldn't manage on his salary and commissions. So, A. D. found a way to get around the sales-slip system. He made the customer's original slip for a higher amount than the other two slips. Then he simply pocketed the difference. It was a good scheme, but very short-lived. A. D. got sick. His customers were delighted with the lower prices his substitute gave them and said so. The substitute checked with the office to be sure he was using the correct price list—and so put an end to A. D.'s "gold mine.")

Some experiences warn how to restrict the activities of outside salesmen. Don't allow outside men to receive cash from customers if you can find some other way to collect. If you must use them, you should indicate clearly on all receipts given to customers that checks must be made to the order of the company and not the salesmen. Use these rules, too:

Make sure that all cash-collecting salesmen are bonded
See that their receipt books are serially controlled in duplicate
Investigate carefully all instances in which the customer indicates that a salesman has already been paid
Follow carefully failure of customers to pay accounts billed on order taken by salesmen
Have salesmen's orders and cash carefully balanced by someone outside the selling department
Don't permit salesmen to use sums collected for their expenses; if this has to be done, make sure that it is properly controlled and recorded

How you can stop over-the-counter sales thefts

I had this experience with Miss M. K. She was a combination salesclerk and cashier in a women's accessory shop. One day, just before payday, she

was short of money. Instead of making a sales slip for a $5 balance, M. K. merely pocketed the money. Her intention was to make up a slip and pay the money back *as soon as* she got her salary.

But on payday she saw a dress she liked and bought it. Result—she could not pay back the $5. Unfortunately for her, it was not discovered, and so M. K. went on to bigger and better things. When we caught up with her after a couple of years, she had piled up a tidy little shortage of approximately $2,600.

Sales across the counter always offer this trouble. The customer pays a bill and the employee pockets the money. You have to do this:

When salespeople must take the cash, have them give a receipt that is serially controlled in duplicate
Educate the customer to understand the necessity for a receipt and to demand it
Inform customers that a receipt is essential to secure subsequent adjustment of accounts
Maintain a perpetual inventory of stock in stores where counter sales are made
Make sure that counter salespeople can secure stock from no other source
Don't permit collecting counter salespeople to disburse any funds received
Utilize the protection of modern equipment for counter sales, particularly cash registers, autographic registers, charge registers. Balance sales registered with cashier's funds daily. If possible, have the actual balancing performed by persons other than the sales or cashiers' group

What to watch for in cash handling

Study the way your employees handle your daily receipts. Control is obtained by a combination of several steps:

Have someone other than the cashier take deposits to the bank
Make deposit slips in duplicate to receive bank proof and prevent forgery
Prove daily deposits to bank records. If possible have this done by someone other than the person receiving the cash
Reconcile all bank statements regularly. If possible, have the reconciliation made by a person other than the cashier
Reconcile bank balances occasionally at periods other than the close of the month
Make certain that "lapping" (the holding back of funds despite entry in the receipt records) is not possible
Compare your receipts with budgets, standards, and ratios in daily or periodical reports. Investigate all unusual divergences from forecasts or normal trends

Make certain that it is impossible for cash to be taken by not reporting sales

Be sure that unauthorized or improper allowances cannot be entered

Make certain that it is not possible for cashbooks to be juggled or forced, particularly in the discount columns

Be certain that it is not possible for a charge to be made to an expense account to cover abstracted cash which is to be credited to a customer

Be sure that articles cannot be lost; for example: goods sold without an entry in your books; interest received from customers on their notes and accounts and not entered; proceeds from sales of by-products, waste, etc., not properly protected; interest or dividends due on investments not received

Check all deductions from remittances such as cash discounts, commissions, disputed sales, account payable contras, etc. Make certain that a cashier or salesman cannot misappropriate any payments received on accounts that have been charged off

One way to avoid fraud in your collection of charge accounts is to divorce the people handling the customers' ledgers and those who handle collection of charge accounts. And you should require rigid approval of all reductions of customers' accounts for bad debts, allowances, discounts. Do this, too:

Review all reductions of accounts carefully

Make the mailing of customers' statements a function of the accounting department

Make certain that reduction can be charged to no place other than the account provided

Use your bonding company fully

You want to make full use of the protection and services afforded by the commercial casualty companies. They keep trying to tell us that they do more than pay losses, including the damage to insured property, premises, and fixtures resulting from actual or attempted crime. The insurance companies also—

Assist in "screening" employees, both present and prospective

Exercise moral restraint on employees, both old and new

Assist in developing effective, efficient preventive measures against loss from dishonesty

Assist in recovering if the loss exceeds the insurance

Inspect the premises and recommend proper physical protection against loss by burglary or robbery; *i.e.*, safes, alarms, watchmen, bars, locks, and other safeguards

Provide complete protection of assets against criminal attack, from both inside and outside crimes

How to stop customers' shoplifting

The growing number of thefts should serve as a warning to retailers to strengthen their defenses against the shoplifter. The retailer who adopts an "it can't happen here" attitude may discover too late that it *has* happened, and to the extent of several hundred dollars' loss in stolen merchandise.

Who is the shoplifter? Foiling the shoplifter is not an easy job for retailers. It is complicated by the fact that the shoplifter frequently is not a habitual criminal but is instead a respected citizen. In many instances, apprehended shoplifters have turned out to be professional workers, businessmen, well-to-do matrons, and other persons of good standing in the community. Unlike the professional shoplifters, they often have no real need for the items taken and sometimes can give no explanation as to why they took them. The retailer must be on guard against both the professional shoplifter who steals for a living and the amateur shoplifter who takes the merchandise simply to be taking it or because he might otherwise have to do without it. This means that the retailer must be ever watchful, never assuming that a shopper is honest simply because he or she is well-dressed and appears respectable.

How do you thwart the shoplifter? There are a number of steps which you can take to thwart shoplifters. First familiarize yourself with some of the more common methods by which they take merchandise. Armed with a knowledge of their tactics, you stand a better chance of detecting and apprehending them. Here are the mechanics they use:

Perhaps the most common way in which the shoplifter steals merchandise is by concealing it within an innocent-appearing object he is carrying.

Frequently used receptacles for stolen items are shopping bags, boxes, closed umbrellas, and brief cases.

More ambitious shoplifters who take greater pains in the preparation of their equipment sometimes prepare boxes with ingenious false tops or bottoms. They slip stolen items into the boxes by raising the false tops or bottoms, which are pulled back into place by strong rubber bands attached to the inside of the package.

Articles of clothing that he carries or wears are another tool of the shoplifter.

A person carrying a coat on one arm deserves careful observation by the retailer, for shoplifters often carry garments over their arms in order to conceal stolen items beneath them.

Other shoplifters wear specially prepared clothing with concealed pockets into which they drop stolen merchandise.

The seller of women's apparel must keep particularly close watch on garments taken into dressing booths by customers. For example, many a store has discovered too late that a customer who took several dresses into

a booth failed to return them all. The customer walked out of the store wearing the missing dresses beneath her own dress.

Jewelry shoplifters often use specialized methods. In one method, the shoplifter, while examining a valuable item, swiftly conceals it, substituting for it a cheap but accurate imitation. In another method, the shoplifter has concealed in his hand a clamp attached to strong rubber bands which run up his sleeve and are fastened to his vest. While examining a ring or other piece of jewelry, he fastens the clamp to it, and the next instant it has vanished up his sleeve.

Shoplifters sometimes work in groups, several appearing in a store at the same time. As one or two of them distract the salesperson's attention, the others busy themselves taking merchandise.

Those are some of the more common ways in which the shoplifter operates. He has, of course, many other methods—some quite simple, others very ingenious. You should watch for these other methods and remember accounts of them so that you can be on guard against them, too.

How can you cut shoplifting? To cut shoplifting you should organize to ensure the safety of your merchandise by keeping display counters and tables low. That permits close observation of customers and their actions. And do this, too:

Instill in salespeople the necessity for keeping careful watch of their merchandise and their customers. This can be done by making theft prevention a part of the initial training of every new salesperson and by periodically reviewing the subject.

Keep valuable items in protected showcases. Train salespeople to show only a few such items at a time to a customer, returning unwanted items to the showcase immediately.

Instruct salespeople to report promptly any suspicious actions of a customer. The retailer can then decide personally what steps to take. Unless he is reasonably certain that a shopper has taken merchandise and still has it in possession, it may be wise for him to avoid taking any action. Erroneous accusations may lead to serious suits against the store.

Engage the services of a reputable protection agency. A sign stating merely that the store is protected by "such-and-such agency" may serve to frighten away shoplifters. If thefts do occur, the protection agency can investigate and possibly recover the merchandise.

How to protect against robberies

This part is paraphrased from an excellent booklet by the Continental Casualty Company of Chicago, Ill.

Secrecy is the best messenger protection for the average small businessman. Trips to the bank or other regular exposure should not occur at the same time every day and, if possible, not always on the same day.

Routes should be changed frequently. Several people should alternate in carrying the money. Another good practice is for the custodian to carry the money in several places on his person, assuming that a messenger satchel is not used.

Checks and money orders should not be included in the package or packages containing cash. The average thief destroys checks and money orders. He takes them only when they are in, or attached to, the packet containing cash. A separate package for these items frequently prevents complete loss.

Bank deposits should be made as late as possible each day. Before closing for weekends or holidays, all cash but what is necessary for reopening should be removed. Armored car service may be necessary for the removal. Or a large part of these funds may be deposited in a convenient night depository, if one is accessible.

The most effective measures available are these:

The use of an *armed guard* is a matter of judgment. In some neighborhoods a $500 exposure would make guard protection mandatory. In other districts a custodian traveling a short distance could safely carry several times that amount without a guard. Guards, if used, should never walk beside the custodian or ride in the same conveyance with him. They should follow the custodian at a distance of 50 feet if on foot or 50 yards if traveling in a car.

It is preferable that money or other valuable property be transported by *private automobile or armored car,* depending on the circumstances and the amount involved. In addition to affording better protection, use of a conveyance facilitates transport of the property.

Handbags designed to frustrate messenger holdup are available on the market. Approved bags are lined with steel or mesh and are attached to the custodian or to the vehicle by means of a steel or wire strap or chain. A very effective bag is equipped with a harmless gun which shoots loudly and emits a trail of smoke when taken from the messenger.

A *small steel safe* or box commonly called a locker is obtainable from most safe companies. Designed for the use of custodians making cash collections, these safes or boxes are bolted to the car and have slots through which the funds received can be deposited so that in event of holdup they are inaccessible. This is excellent protection for collectors, salesmen, and drivers.

Holdup alarm systems are in common use to avoid store or shop robberies. Unfortunately, however, these devices are not very effective in preventing robbery. Because of the speed with which modern bandits operate, it is usually impossible for the police to respond in time to prevent loss. An alarm may frighten the inexperienced holdup man, however, particularly if a loud gong is set off. Other useful aids are—

A *slotted safe* of the round-door, so-called "burglary-proof" type, has an inner slotted compartment into which money can be deposited. The door to this inner compartment is locked either with a delayed-control time lock or with two keys. The combination of the delayed-control type has to be set from 15 to 30 minutes before the door can be opened. Most bandits, as experience has proved, will not wait that long. If the two-key type is used, one key should be in charge of someone usually off the premises or at least well removed from the vicinity of the safe. When this type of safe is used in connection with the pickup service of an armored car company, one key may be given to them.

A *tear-gas* system of an approved type is effective in preventing robbery losses. These systems are usually operated by hand buttons or foot levers located in hidden places but easily accessible to the merchant or his clerks. In event of a holdup, pressing the button or lever releases tear gas from guns strategically placed about the premises. This renders the bandits more or less helpless.

A *bandit-resisting enclosure* may be needed in places handling large amounts of money. It is wise to explore the practicability of such an enclosure. It can be constructed of bulletproof steel, wire, and glass. There should be two doors, arranged in vestibule fashion with electrical controls from inside, so that only one can be opened at a time. When such enclosures are used, money must be delivered after the enclosure is occupied by the cashier or paymaster to frustrate early-morning kidnaping.

Casters should be removed from safes and, when possible, safes and chests should be embedded in concrete or bolted to the floor. This precaution prevents removal of the safe from the premises, to be blown open at leisure.

Safes and chests should be visible from outside the premises. A light should be kept burning above them at night. Local police should be notified of this practice.

Time-recording locks are used by many stores. Operated by a key and containing a tape on the inside, the lock automatically records the key number and the times of opening and closing the premises. These locks provide an excellent check on employees. They also identify an employee entering the premises after hours, thus acting as a preventive against theft by him, whether acting alone or in collusion with others. Where this lock is used, an ideal arrangement is to install it on the front entrance and to deadlock and crossbar all other doors.

An *auxiliary lock,* operated independently of the ordinary spring mortise lock, should be installed on all doors. The bolt of these locks cannot be moved except by use of a key or an inside knob. A double cylinder deadlock is one which can be operated only by a key on either side of the door.

A crossbar of heavy wood or iron, placed horizontally across the inside of a door, is a good idea. The ends of the bar are held in sockets or supports securely bolted in place. If possible, the bar should be permanently fastened at one end and padlocked at the other. These bars are particularly useful for alley or poorly lighted entrances.

Sheet-metal reinforcement is sometimes desirable. When used, the metal should be at least 16 gauge ($\frac{1}{16}$ inch thick) and should be screwed to inside of the door with heavy screws or bolts not over 4 inches apart on all sides.

Screened or barred windows are good protection against breaking and entering. This is particularly true for windows opening on alleys or other poorly lighted areas, skylights, and occasionally display windows. Screens or bars are most effective when installed on the inside.

Grills (demountable screens of No. 9 gauge wire or light iron bars) should be used to protect glass door panels, show cases, or show windows containing valuable displays.

Electrically operated burglar-alarm systems are available on the market. Used on doors, windows, and other openings, and occasionally on vulnerable walls, floors, or ceilings, these devices are very effective in ringing loud alarms. They also signal a central office when entry is forced into the protected premises. Substantial discounts in burglary-insurance premiums are allowed for approved types.

Watchmen, if employed, should remain within the premises at all times after closing. A central station watchman signals an outside alarm company station or police station hourly to indicate all is well. A clock watchman records hourly rounds of the premises. The clock should be checked the following morning for omissions.

These and other protective measures will not completely eliminate the danger of burglary or robbery. The professional criminal is both well versed and well equipped in carrying on his business. But no experienced criminal takes unnecessary risks. The more effectively you set up safeguards, the less danger there is of a loss.

And watch out for these confidence men

The credulity of many Americans was recognized by P. T. Barnum when he made his famous remark about a sucker born every minute.

Swindlers are constantly planning to separate gullible people from their money. There are a wide variety of business frauds whose complexity varies with the art of the swindler and the simple-mindedness of the victim. Various schemes are presented so plausibly that not only inexperienced men but even the most wary are frequently induced to make investments, only to find the promised fabulous returns are a will-o'-the-wisp. Here are a few of the more common frauds:

The *advance-fee scheme* has been used by many swindlers in a variety of frauds. Confidence men advertise in a trade journal that they are in a position to finance new business ventures through the right connections in the world of finance. A charge is made to all victims who respond

to cover a "prospectus" and other "costs." The prospective businessman never hears from the promoters again.

Businessmen seeking sales have been solicited to *put up a bond.* The swindler never accepts a surety bond but always requires cash. After handing over the money to the confidence man, the victim never sees his slick friend again. A responsible bonding company will issue a surety bond for a small fee. Don't bite for the cash-bond racket.

Mail-order schemes offer a lucrative field for swindlers. These swindlers require payment in advance, either in whole or in part. There is little hesitancy on the part of the businessman, particularly when the goods are in short supply. Recently, some 8,000 dealers contributed to a swindler vast sums for the sale and delivery of alarm clocks, toasters, and electric irons. A payment of one-third down was demanded of each victim. When the fraud was discovered after the swindler had departed to new and undeveloped territory, the unopened mail was estimated to contain more than $25,000. These mail-order frauds vary only with the amount and type of goods sold.

Many frauds find their victims in men who are anxious to get into business. Here are some of them:

A common fraud is to sell *the rights to an exclusive distributorship,* which proves to be anything but exclusive. In fact, upon investigation, the victim finds equally industrious residents of the community are also "exclusive distributors" of the same product. In this type of fraud where goods are shipped to the so-called "exclusive distributor" the goods turn out to be inferior, shoddy, and usually unsalable.

One of the schemes in current vogue is the sale of *exclusive territorial rights for vending machines.* The territories are soon found by the purchaser to be exhausted, and, in many instances the vending machines are in a virtual state of collapse.

Catch slogans in persuasive advertising are used by a swindler to stimulate the victim's spirit of individual enterprise in purchasing *an interest in a fake partnership or business.* Some of these enterprises are nonexistent. A swindler may say a store is for sale. The shop is filled with confederates of the swindler who create an atmosphere of false business activity. Investigation after purchase by the victim discloses that even the boxes on the shelves, which were supposedly filled with merchandise, are empty.

A wide variety of stock frauds are practiced, varying in detail with the skill and ingenuity of the operator. These promoters, on the basis of misrepresentations and distortions, sell securities for enterprises which are destined to fail. A simple investigation by the victim would clearly show the lack of merit in the enterprise.

The state of New York (in connection with its stock-fraud activities) has issued the following cautions:

Know or find out the responsibilities of the person or firm or company asking you to purchase.

When the person is unknown to you, demand references and investigate. Do not be a victim of the one-call system. Take your time when strangers try to sell you securities.

Do not hesitate to ask your banker or your lawyer, the chamber of commerce, the board of trade, or the better business bureau what they think of the proposition.

Inquire of some reliable person or firm familiar with the character of the business in question for an opinion of both the standing and prospects of the company.

Do not believe that the sensational success of one company is a guarantee that any other company will succeed in the same business.

Remember that bonds become just as worthless as stocks when the security they represent is impaired.

Take notice that what may seem to you to be guarantees by promoters or stock salesmen may, after all, be legally considered nothing more than opinions or hopes or a statement of mere prospects. The value of a security depends upon the integrity and financial strength of the guarantor.

When printed agreements are offered for you to sign, remember that separate promises by salesmen, if not in the printed agreement, are not binding upon the company.

If you become victimized by swindlers or are suspicious of the actions of any company or individual in transactions in securities, do not delay in notifying the Office of the State Attorney General. Not only do you thus place the crooks in the way of punishment, but you also protect other persons as well as yourself.

And above all else do not swap your safe investments or savings for worthless securities!

What can you do about it? The schemes tried and tested by confidence men and productive of rich returns to swindlers are repeated time and time again. As you read the reports of these swindlers, you will find that they do not vary much. The old vehicle is given a new coat of paint. But the skeleton of the old familiar scheme is always there.

The Post Office Department urges this: if you receive literature through the mails advertising a fraudulent promotion, if you have reason for suspicion, or if you have been victimized by a swindler by use of the mail, immediately communicate with the Post Office Inspection Service.

Better business bureaus, chambers of commerce, and banks are ready to offer their services and advice in connection with promotional schemes.

In addition, the following warnings should be heeded:

Before you sign a contract, read it and make certain you understand it. And don't fail to get a copy of the contract.

Many unhappy losses have resulted from turning over a signed blank to an unscrupulous promoter. Refuse to sign a blank form which is to be filled in later.

Do not hesitate to consult an expert concerning any problem about which you may be in doubt, even though the promoter may tell you that the matter is simple and that a man of your profound comprehension can easily understand it.

If the promoter says that you only have a limited time to act, or that you

must decide right away, do not fall for this obvious bait. Don't be high-pressured into a financial venture which mature consideration will show cannot possibly succeed.

If a promoter flatters you, telling you what a brilliant fellow you are, and how quick you are to discern real value, beware!

Demand references. If the promoter hesitates or tries to evade the question, watch out—the chances are he is unable to provide them.

If a promoter is unwilling to disclose the terms of his proposal, claiming that it is a secret which will revolutionize the industry, do not make any investment until you have a full disclosure of the facts. In short, insist on proof at all times. And beware of promotions which will revolutionize an industry.

Finally, remember you won't get anything for nothing—that is, anything of value.

4. HOW GOOD TAX MANAGEMENT CAN INCREASE YOUR NET PROFITS

Tom Clarkson, foreman of the assembly department of the big Ace Manufacturing Company local plant, had saved and planned for years before he quit his job to go in business for himself. He'd be his own boss, with a filling station at a likely spot on the Boston Post Road. Getting enough capital together to realize his dream of his own business had taken years of prudent saving, but he was sure that being in business for himself would be worth the sacrifices.

Dick Clayton, machinist in another Ace plant, had the same dream of independence, being his own boss, getting away from bench work and back to automotive service and repair. He didn't have much money, but his family was back of him and his credit at the bank was good.

Harry Aubrey, ledger clerk in the Middle Western plant of the Ace Manufacturing Company, looked down a vista of long years of sitting at a desk, writing figures in a ledger, and decided he wanted no part of it. He wasn't a trained businessman, but he knew that there was money to be made in operating a service station, and he figured that he could make up in enthusiasm, hard work, and common sense what he lacked in actual experience.

Here they are—just three men out of the hundreds of thousands who each year realize their dreams of going into business for themselves. Tom set up his station in the busy competitive thoroughfare between New York and Boston; Dick's station was also well placed, on the highway below St. Augustine, Fla., and Harry's was in Wisconsin's vacationland, north of Madison.

At the end of a year, each had done about $20,000 in business, with profits close to the normal expectancy of 16½ per cent.

But—

Tom, who knew more about car servicing than either of the others, was in need of more money.

Dick was in only fair shape financially.

Harry was doing fine, thank you. The answer: *Taxes.*

* * *

Tom, who knew the business, had gotten good advice on such matters as station display, auto supplies for sale, and servicing equipment. But he had neglected to get information on methods of reducing his tax liability.

Dick, with less knowledge of automotive servicing, had the benefit of some information on saving tax costs from relatives who owned a store.

Harry, wisely realizing that he lacked information on all phases of operating his own business, consulted his CPA as well as advisers on running a service station. As a result, at the end of the year he was able to realize a good income without painful tax involvements.

* * *

Tom, with only his son helping him to start out, felt it was unnecessary to incorporate and considered no other alternatives. He bought his service station and equipment outright.

Dick organized a partnership with three other members of his family and divided the profits evenly. He too bought his station and equipment. He came out with a small tax bill.

Harry, on the advice of his CPA, organized a partnership. He leased his equipment from the oil company on a profit percentage basis instead of buying the station outright. He paid no taxes.

Poor tax planning can easily offset business efficiency

The accompanying table shows tax scales to which each was subject. Remember the facts—

Tom —Sole owner of business assets and operations.

Dick —Partnership with three relatives, jointly owning all business assets and dividing profits evenly. Tax is total for all four.

Harry—Similar joint partnership of four. All assets leased (none owned) at a rental of 20 per cent of the profits earned. Tax is total amount for four partners.

Here is what each group paid:

Net profits	Taxes paid for 1955		
	Tom	Dick	Harry
$ 5,000	$ 660	None	None
10,000	1,636	$ 848	$ 488
15,000	2,960	1,760	1,220
20,000	4,532	2,640	1,940
25,000	6,344	3,576	2,640
30,000	8,434	4,564	3,376
40,000	13,354	6,544	4,960
50,000	19,002	9,112	6,544
70,000	31,390	14,840	10,672
100,000	52,056	25,376	18,128

Private small business offers large profits in an expanding economy. Ownership of business assets serves as a good hedge against inflation. The banks are eager to make sound loans to promising young businesses. With all these inducements—the blank areas in the nation's business machine—a real temptation is always furnished to seek the dignity of owning a business.

But there are drawbacks. Only one out of four of the ambitious novices has the qualifications of business experience or training and the capital to carry through. *The records show that one out of four retail ventures fail in the first year, half succumb within 3 years, and only two out of ten last through a decade.*

Taxes being what they are, good tax information permits sizable savings. The problem of *how* can best be expressed by this sort of question (there are many others):

Does it pay to incorporate? to operate as a proprietorship (single ownership)? to organize a partnership? to form several units, as partnerships or corporations?
Will a family partnership cut taxes enough to make it worth while?
How should costs of building and equipment be financed?
Do tax savings make leased equipment cheaper than outright purchase? Should the building be rented or purchased?
How may the business be financed most cheaply? How should books be kept—cash or accrual? With what tax year?
Can dependents help out without losing tax deductions?

Tax effects from renting vs. owning

Many new businesses have been able to secure bank loans to finance purchase of equipment. But the path of tax wisdom may be to lease the equipment on a graduated percentage basis. As sales income grows, the cost of the leased equipment goes up. Tax deductions are also on a graduated scale; when the income is low, there are lower deductions. When income goes up, the deductions increase even as their importance to the businessman increases.

Such advice would have been particularly helpful to the new service station operators. Some of the major oil companies are particularly agreeable to leasing arrangements.

Many businessmen who purchase buildings on an FHA or similar long-term plan assume that their monthly payments are rent—a necessary, deductible evil. But only that part of the monthly payment which represents interest and real property taxes is deductible. The balance of the monthly payment is not deductible. It is repayment of a loan. The same breakdown applies to mortgage payments.

Another example: should you buy the automobiles you need for business traveling? It may be tax-wise to pay a rental. There are some places that give you brand-new, small cars for a $55 per month plus 1 cent a mile. In these deals the lessor pays for all insurance and licenses. You pay for gas and oil and repairs. That may be a much better tax deal than to invest $2,500 in a new car. If you rent, all your costs are deductible. When you buy, annual depreciation at probably 20 per cent takes the place of the $55 and 1 cent a mile.

If investment and tax considerations are important, take the rental. In fact, it is always a good motto to invest only in a tax deduction.

Financing your business has direct tax impacts

Many new businessmen receive some of the money to start from relatives. They feel obligated to offer stock in the business in return. Actually, from a tax standpoint, this is unsound. Dividends paid on stock are not deductible. The helpful relatives could receive the same return in the form of interest on loans, or promissory notes, or bonds. Interest repayments in all three cases are deductible.

Employing your dependent children may have tax advantages

You may employ your child in your business and pay him a reasonable salary. That gives you a deduction for the fair pay you give him—plus the exemption you get for supporting him. On top of that, he gets a $600 exemption on the pay he receives.

You get the exemption even if you pay him $600 or more—as long as he is under nineteen or a full-time student. If he is nineteen or over and does not go to school, you can still get an exemption if he earns less than $600 during the year.

How you keep your records has a tax effect

A businessman's early problem is to decide whether to keep books on an *accrual basis* (income and expenditures are noted as soon as the transaction is completed) or on a *cash basis* (income is noted, and expenditures deducted, when cash is actually received or paid out). Get your CPA to help you select the best method for you.

Any business which has inventory—such as filling stations—must be on the *accrual* basis. When Tom Clarkson sells 10 gallons of gas to a charge-account customer, the item goes into the ledger immediately, although the money may be 60 days away.

What year should you use for tax reporting?

Another problem is to determine the tax year. For most people the tax year starts on Jan. 1 and ends on Dec. 31. This period is called a calendar year. But business reasons may determine a different reporting period. That is, if your natural business year does not coincide with the calendar year, you pick the period that gives you the best picture of your business. When you do this, your reporting period is called a fiscal year, which means a period of 12 months ending on the last day of any month other than December.

You may even get some tax advantages when you pick a fiscal year. Let us suppose that Tom Clarkson and his son opened their filling station in January. By having the tax year end June 30, the Clarksons' CPA could have enabled them to pay taxes on only $3,000 for their first, critical business year, delaying the obligation on the remainder.

But in choosing a fiscal year for a partnership form of business, we have to watch out for certain bars. A partnership cannot adopt or change to a taxable year other than that used by all of its principal partners unless it can show a good business purpose for doing it. For example, if the principal partners report their personal income on a calendar-year basis, then the partnership must use a calendar-year basis unless it can show a business reason for using a fiscal year.

Your business might even call for a 52–53 week fiscal year. That is, you want to close your annual accounting period on a particular day of the week rather than on the last day of the month. Under this method, your tax year will be measured by weeks rather than months. So you will, on the average, have five 52-week fiscal years to each 53-week fiscal year under this method.

Example. You close your weeks on Saturdays and you want your year to close in December. If the last Saturday in December is Dec. 25, your tax year ends Dec. 25 of that year.

Taking your time in picking the proper accounting period will avoid the necessity of obtaining permission to change the tax period later. Watch these points:

If there are inventories you will be bound by the valuation election you make in a first return—as between cost and cost or market, whichever is lower. Find which is more advantageous for you.

You will be bound by a choice between the method of deducting specific bad debts and deducting reasonable additions to a bad-debt reserve.

Legitimate aids in cutting your income for tax purposes

There are other tax-deferring or tax-cutting ideas that are pretty useful to the small businessman.

You can defer sales income to next year this way: arrange to ship merchandise on consignment this year to be sold next year. Or you may arrange to sell merchandise on approval this year, to be accepted next year.

If you use the accrual basis of accounting (as you must do if you have inventories), trade and cash discounts give you a control of income. Give *trade* discounts on your sales if you want a deduction. Take *cash* discounts on your purchases if you want the income. A trade discount reduces your sales (or purchases) at the time of the transaction. A cash discount is a deduction only at the time payment is made.

Example. In December, 1954, you sell $1,000 merchandise subject to a 10 per cent trade discount; while you buy $1,000 merchandise subject to a 2 per cent cash discount. Both bills are paid in 1955. You accrue, in 1954, $900 sales and $1,000 purchases.

Can you use the installment sales method? If you regularly sell your merchandise on the installment basis, you can defer the gross profit to the year when you collect. Nor is it necessary to make all your sales by that process. You can use the installment method on your installment business, provided you regularly sell that way. If you sell refrigerators and pianos, and allow installment payments only on the first, you qualify.

The income reported on installment sales is found this way:

Year	Total sales	Cost of sales	Gross profits	Profit %	Collections in 1955	Income reported in 1955
1953	$50,000	$25,000	$25,000	50	$20,000	$10,000
1954	80,000	48,000	32,000	40	30,000	12,000
1955	60,000	42,000	18,000	30	10,000	3,000

Expenses and other deductions are deducted in the year when paid (cash basis) or when incurred (accrual basis). They are not allocated to the years when income upon collection is reported. When would good tax management suggest that you use the installment basis?

If you are on the accrual method of accounting and you want to change to the installment method, make sure you are not taxed twice in the change-over. When you change, your collections may include income that was accrued in a prior year. This income is reported again

You might use the installment basis	*You might not*
When you expect lower income in future years	When you are building an installment business and your deferred income will put you in too high a tax bracket in later years
When you want to avoid paying tax on a sale until you collect	When you are concerned that you will have a large income in a period when business is really decreasing; you may have to pay a tax, if you use the installment basis of accounting, when your income is very small, or when you really have a loss in operations
When you want to siphon off present income and spread it over future years	When you have losses; the law applies only to gains
When you expect a declining tax rate trend	
When you are certain of the result of your step; once you select this method you cannot change by filing an amended return	
When you want to build up your working capital by deferring the tax to later years	

If you are in the installment business, you probably ought to use a corporation.

Do *not* take advance deposits of any kind from your customers or contractors unless you are prepared to pay a full tax on those receipts. If you have use of the money, it may be taxed to you. But your deduction of expenses incurred to earn the deposit may have to be spread over the life of the contract or lease. This denies you the privilege of allocating income to a year other than the year of actual receipt. There have been pleas that inclusion of these amounts in the income of the year in which they were received prohibits a correlation of income and the expenses incident to the earnings, but these pleas have not been successful.

Since unrestricted advance payments are income, you may take advance income in years when your business has lost money. Then taking advance income will eliminate income from taxed years.

Tax economy in reporting your deductions

Some expenses can be controlled and placed in the year in which they will give you the most benefit. You may elect to spend money this year for repairs, redecoration, advertising, etc. Or you can delay them until next year, if that will give you a greater tax benefit.

Does good business dictate that any of your expenses be rearranged to a *percentage* of sales or of net profit? For example, can your rent be based upon a percentage of sales or profit? Your job is to control costs so they will be low when your net income is low.

If you own assets (say machines or automobiles used in your business) and are about to trade them in, remember this: *a trade-in produces no gain or loss.* If the allowance is more than the depreciated cost of your

asset, trading is best, since the gain is not taxed. But if it is less, sell the asset for cash and get the loss. Then use the cash to buy the replacement.

You can get no deduction *now* for costs which you may have to make good later on present-day sales. The classic example is the contractor who must include his full contract receipts in income today, even if he remains responsible in the future for his guaranty of his work. But one 1951 case disregarded this rule and allowed the contractor a current deduction.

Tax economy may mean detailed study of this list to find what you should do about clearing up *in high tax years* costs such as—

Guaranties and warranties that will carry on after this year—they are a deduction if you pay this year

Expenses contingent upon the customer paying his bill, like discounts, salesmen's commissions, etc.—you might get a deduction only in the year when he makes a payment; the courts disagree on this point

If you contest expenses you are not entitled to a deduction until the matter is settled. You have no deduction until your liability is fixed and certain. Contests of expenses must be studied if the deduction is important to you this year. For example, consider settlement now of—

An employee's claim for damages for breach of contract of employment

Claims for accidents, guaranty of lease, and breaches of contract generally

Assessments on state and local taxes. You should pay these amounts together with interest accrued. (You may file immediate claims for refund of the taxes and the interest paid)

Interest accrued on Federal income taxes. You should accept assessments on these taxes and pay them together with interest accrued. (You may file immediate claims for refund of the taxes and interest paid)

Sometimes you can gain tremendously, taxwise, by liquidating (in high tax years) obligations that will carry into more difficult years. For example, *you probably can get an immediate deduction if you settle in cash for*—

Bad leases that are likely to be burdensome in later years

Contracts for services or materials that eventually will be expensive and difficult to carry in later years, or sales contracts which may be difficult to perform

Many kinds of adverse litigation or contingent liabilities, and all related expenses. Liquidate them now when taxes are high

Obligations for a purchased asset that will not be used in later periods. See if you can get a present deduction by returning the asset and taking your loss now

What is your best business form for tax purposes?

It looks good to see the sign over the business: "Tom Clarkson, Prop."

Tom Clarkson thought so, even though his son worked part time and furnished some of the capital from his own earnings (an investment). As a partnership they would have divided profits, cutting taxes below the levies on his individual proprietorship or a corporation.

The tax liabilities of the individual, partnership, and corporation are vastly different. You want to know about that when you have the option of choosing any of the forms for doing business.

The latter half of this chapter shows you the relative advantages of a partnership and corporation.

When you study these forms, consider the possible use of *other devices*. For example, check with your CPA the tax help you can get by—

- Selling directly to a locally financed independent merchant, manufacturer, or jobber instead of having separate entities where you do business
- Leasing your facilities for handling sales to local agent upon agreement to handle your product exclusively

Check, too, the tax desirability of *two or more* corporations or partnerships to handle your present business operations. See your CPA for possible advantages. Recognize that lawmakers today favor small enterprise. It is always best to fit yourself into the exemptions and credits by which they subsidize smaller companies. And consider, too, with your CPA the *division* of your business for tax purposes by—

- Having both a corporation and a partnership—or any other combination
- Leasing all or part of corporate assets to some established business for—
  - Part of gross sales
  - Percentage of net earnings
  - Flat annual sum
- Use of the parent-subsidiary company device, through—
  - One company merely owning stock of another
  - Division of operating company into two or more parts

Joint ventures can give cash-basis individuals a good deal of tax control of the year for taking a possible loss that may arise. Two examples can show the way:

Example 1. A and *B* formed a small business. Profits and losses were to be shared equally. These losses were deductible *when they occurred,* even if one of the parties took 10 years to pay the other for his share.

Example 2. A and *B* formed a small business. *A* wanted to be sure to control the year of his loss if one were sustained. So *B* was given ownership

of the business. *A* told *B* that he would share gains and losses equally. *A* then got a loss *when he paid B his share.* In this case, the loss to *B* occurred in 1929. *A* gave *B* his note for his share of the loss in 1930. He paid the note in 1941. That, held the courts, was year of his loss. (*A* was not deemed a joint venturer. He was merely under an obligation to reimburse *B* for losses.)

If you are in a joint venture, and your income is low this year, you may take the gain from the venture in this year. That is done by terminating the venture this year, even if the work is not completed.

Example. Assume *A, B,* and *C* organize a joint venture. Before completion of the work, *B* and *C* can withdraw from the venture and accept from *A* settlements of their shares of the profits. *A* alone finishes the work in a later year and reports on the completed contract basis. Despite this, the settlement with *B* and *C* terminates the venture and closes the transaction in the year of settlement.

Even if you expect to use the corporate form, consider starting your small business as an individual proprietorship or partnership if the first few months are likely to show a loss. The losses can then be set off against your other income.

The corporation can use its losses through the 7-year net operating loss deduction given all business. But if you are in a higher individual bracket you usually can effect a much more substantial saving.

Then later you can change your business to a corporation, *without any tax cost.*

Suppose the early period proves the new business to be a "dud," with losses. If you wind it up, the individual proprietorship or partnership form permits you to offset the entire loss against your personal income. Had you used the corporate form, the only loss realized (from worthless stock or loss in liquidation) would be a capital loss. That may not give you much tax saving.

Tax considerations in operating a family business

Since much of the confusion about family partnerships has been removed, many family partnerships have been recognized for tax purposes where a partner gets his interest by a valid gift. This gift of part of the family business to children will split the family income.

That the only reason for the gift of the partnership interest is to cut the family taxes doesn't mean a thing. But the transfer of the partnership interest must be real. No sham ownership will split the family taxes.

These rules apply only if the partnership is one where capital is an

important income producing factor. So, they do not apply to personal service businesses. Also the partner who gives up the interest by sale or gift must be credited with compensation for his services. This is in addition to his share of the partnership income coming to him as a partner. Nor can the sharing of the net profits by the new partner after deducting for the compensation to the donor be greater than the ratio of the gifted share to the entire partnership capital. For example, a gift to a son by his father of 25 per cent of the capital can only give the son a 25 per cent share of the profits, after the compensation allowance to the father.

If a person buys an interest in a partnership from a member of his family it is treated as if he got the partnership interest as a gift. The rules on the distribution of profit apply. The fair market value of the partnership interest bought is treated as his donation to the capital of the partnership.

If you want to divide profits in a venture with members of your family, it is not essential to create partnerships. In one case, this fifty-fifty split of earnings was approved: a mother loaned her son money to start a new business. For the loan she took the son's demand note without interest. The son agreed to give her 50 per cent of the venture's profits. Still another way is illustrated by these methods:

A mother and son (or other members of the family) may own an undivided share in certain assets. There is no rule prohibiting the mother from renting her share of the assets, at a fair price, possibly including some share of the lessee's earnings. Or, she may rent to a proprietorship or corporation set up by the son; or to an outsider, not connected with the son.

In this kind of division, you might give the working assets to the son to be used in the continued conduct of the business. Give the other assets like investments or real estate to inactive people (parents, children, trusts, etc.). Then have them charge a *fair* rent for the assets that are used by the son or any business he creates.

If you do this, separate the assets so that there is no joint ownership. If that is not possible legally, divide the assets so that *each* has an undivided interest in *each* asset rented. Then have *each* enter lease agreements. That prevents any claim of the existence of any kind of partnership.

A personal-service partnership can be operated by a family group. But the family members must play important roles in producing the partnership earnings by regular jobs—perhaps services in contracts with customers or suppliers—or running a part of the business.

As a general principle, you cannot give a member of your family an interest in your personal-service partnership unless it is true that:

All the facts, the agreement, the conduct of the parties, and the observations of outsiders indicate that a real partnership is intended. Intent becomes the controlling factor.

A family member really takes the risks of a partner. Then it is particularly important that the gift creates a real partnership, that is, that it is one that completely changes the previous economic status of the donor and the donee.

Each partner contributes present substantial control, policy making, and management—regardless of the source of the capital.

Each partner really does important work in businesses where partners would normally be expected to be actively engaged in contacts with customers, employees, and suppliers. The work must be regular, not sporadic. It should be performed daily.

Sometimes members of a family can be part of a specific business venture. For example, in one case, two children were included as venturers in a group organized to buy and outfit a ship. When completed it was to be sold to a partnership in which the father was a partner and which advanced the money used to accomplish the venturer's objectives. The ship was later sold to outsiders—not the partnership—at a profit.

You may be able to get family splitting of income by a *real* assignment of a piece of property you own *without* a partnership—for example, assigning the building in which your store is housed.

This will cause tax to the other members of your family, instead of yourself. As a general rule, unless the property producing the income is assigned, the income itself is not assignable.

You may not avoid tax by causing your income to be delivered to another. If the assignment is merely of income when it is collected, the assignor is taxed. But a gift to a member of your family is recognized if the following can be proved:

You are competent to make the gift

They are capable of taking the gift and accept it

You intend *presently* to divest yourself of the title and control of the property

You make an absolute transfer of the present title and of the control of the entire property

You deliver the physical property or the most effectual means of exercising dominion over it

You no longer can exercise dominion or control over the property

There is a tax to the assignee only where the property giving rise to the income is also assigned. But there must be a full and complete delivery of all right, title, and interest of the assignor in the property.

In family assignments of business interests, remember this important point: Do not tie strings to the gift or retain important attributes that usually are

associated with ownership of the property. Otherwise, you may find yourself taxed on income from that property.

So long as the assignment is bona fide and the business is of a type where capital is an important income producing factor, an assignment of a business interest will successfully transfer some of the business income. Of course, the donor must be allowed reasonable compensation before any of the business income can be transferred to the donee. But these rules still permit great tax saving by assignments of business interests.

How you can get maximum deductions

The proprietor includes his business income or loss in his own tax return. He adds it to—or subtracts it from—the rest of his income.

The same rule generally applies to the partner in a business. He treats his part of the profit or loss as an addition to—or subtraction from—the rest of his income. But a lot of rules sometimes intervene to make that a bit more complicated than it sounds. Read the way partnership income is treated in Chap. 9.

Let's assume you understand the occasional peculiarities of the tax accounting for partnerships. If you do, then the following principles also apply to their income.

First, what deductions do you get from your business income? The general principle is that you can deduct all the ordinary and necessary expenses to earn your income. But watch these rules:

Personal expenses are never deductible. That is so even if you pay for them out of your business. For example, if you write out a business check for the purchase of furniture for your home, that is not a business expense. It is part of your drawings from the business. Your own drawings or salary are not deductible.

Typical business expenses of a mercantile establishment are amounts paid for advertising, hire of clerks and other employees, rent, light, heat, water, stationery, stamps, telephone, property insurance, and delivery expenses. The expenses of a manufacturing business include labor, supplies, repairs, light, heat, power, selling costs, administration, and other similar charges.

Capital costs cannot be deducted. Generally, the cost of acquiring an asset or of prolonging its life is a capital expenditure. The current expenses of running a business are not capital expenditures. Strictly speaking, every purchase of an asset or property (other than inventory) is a capital expense. Yet the law permits a deduction if the useful life of the item purchased is less than a year. For this reason, the cost of small tools, pencils, etc., is deductible. Although capital expenditures are not deductible in the year paid or incurred, their cost may usually

be recovered. This is done through the deduction permitted for depreciation.

These deductions which you take in the business schedule are in addition to the normal deductions given everyone; *i.e.*, taxes, interest, and contributions. You are not permitted to take a deduction twice. If you deduct interest or taxes as an expense of your business, you cannot again deduct them in another part of your return.

You may pay and deduct reasonable salaries to your minor children if they perform services that would ordinarily require an outsider. Each must report the salary as income. Each files a return and pays a tax. Your child may receive less than $600 and have no other income; then he is not required to pay a tax. You may still claim him as a dependent (if you meet the rules on page 53). You are, of course, always entitled to a deduction for compensation paid (in money, property, or shares) to your children who perform services.

You can also deduct amounts paid for household help to the extent that their services are used in a business.

Services of members of your family must be *continuous and substantial* in the operation of your business. They may not be slight or insignificant services such as any wife might perform for her husband or any son for his father.

For compensation to	*You treat it this way*
Wife	No part is deductible. But you can split your income with her. That is discussed later
Adult children	Any reasonable pay and board are deductible
Minor children	If you seek a deduction, be ready to prove that— Real employee relationship exists You actually make payments for services (but payment for schooling or support might be in that class if it is really pay for services) The minor *chooses* to work with you rather than somewhere else. The services must be voluntary, not enforced Actual services are performed—*not* those ordinarily classed as part of the household duties

Many businessmen use part of their residences as a place of business or office. Then a division of the various household expenses must be made between business and personal use. Only the portion allocated to your business may be deducted. No official ruling exists to guide the apportionment. Any reasonable plan will be approved. Here are some aids:

If you own the house in which is maintained both your business and your residence, you may deduct the portion of the heat, light, telephone, repairs, depreciation, etc., that may be fairly allocated to the business.

If you rent the house or apartment, you may make a similar allocation of some of these deductions together with your rental expense. The

apportionment might be made on the ratio of the number of rooms devoted to business to the total number of rooms in the house. Another method in use is the ratio of the area of the business rooms to the total area of all the rooms.

You may have a place of business or office elsewhere and merely see a casual or incidental customer or client in your residence. That is not using part of your home as a business. Neither would there be business use if you rarely used your home for business operations. To get a deduction for the fair share of the expenses allocated to your business activities, you must actually maintain an office and regularly receive customers or clients. Or you must regularly conduct other business activities. You are then entitled to the deduction. You get it even though you use your residence as a place of business only during the evenings or during special hours, and even though your main business is elsewhere.

When your automobile is used for both business purposes and personal uses, an apportionment of your depreciation, repairs, and operating expenses may also be made. Only the portion allocated to your business purposes may be deducted. It is advisable to keep records of mileage, number of trips, etc., in order to prove your fair apportionment.

Sometimes individuals get their personal expenses all mixed up with their business expenses. Here is a check list of deductible costs. It may help you unscramble bad bookkeeping.

Advertising expenses essential to earn your income

Automobile expenses paid by you if your car is used directly in your business

Books purchased for business if their useful life is short. (If they have a long useful life, an annual depreciation deduction may be taken)

Cards, notices, and stationery paid for by you and essential to earn your income

Coaching lessons. (Lessons for the general improvement of your talent are not deductible)

Compensation for employees where paid by you and essential to your business

Contributions and assessments paid to chambers of commerce and professional associations and made for business purposes

Cost of attending meetings or conventions of your business or profession

Cost of bonding employees or assistants

Damages, court costs, and other expenses paid by you in connection with civil lawsuits affecting your business

Depreciation on your tools, instruments, and equipment with a useful life of more than 1 year and used in your business

Display expenses—hotel and sample room costs paid for by you and required by your occupation

Embezzlement or defalcation losses to the extent they are not compensated for by insurance. (This may be deducted only in the year the loss occurs. The cost of apprehending the thief is not deductible)

Entertaining expenses if necessary for your business. (Include dinners, drinks, flowers, lunches, parties, tickets to concerts, sporting events, and theaters, etc.)

Fees paid to agents where essential in order to earn your income

Fire, casualty, or theft losses to the extent they are not compensated for by insurance

Gifts required for business purposes

Instruments or apparatus necessary to earn your income which you rent or lease—cost of renting or leasing

Instruments and equipment used in your profession which you must buy—cost, if the useful life is short; if not, annual depreciation charges and maintenance cost

Laundering or cleaning working clothes or uniforms where the cost of purchasing them would be a deductible item

Legal expense of defending suit against you—except that if you are found guilty in a criminal action, no deduction is allowed

Loss on sale or scrapping of old depreciable equipment or machinery used in your occupation. You may deduct its present depreciated value (cost less depreciation), less the amount received for it

Machines and heavy equipment—annual depreciation only

Magazines and newspapers purchased for the use of customers

Maintenance expense of business premises. Include cleaning, electricity, heat, insurance, light, paint, repairs, water, and incidental alterations

Membership fees paid to your trade association for a business purpose

Messenger service used in earning your income

Miscellaneous or unusual expenses paid by you which were directly necessary to earn your income

Moving expenses incurred in transferring your business to a new location

Office furniture, if its useful life is short. (If it has a long useful life, you may deduct only the annual depreciation)

Office supplies, postage, and stationery

Patent infringement judgments if paid by you

Patterns or designs purchased by you and required for your business

Press agents' fees paid by you

Professional or trade magazines, journals, and periodicals

Publicity expenses paid by you, incurred in earning your income

Rent paid for business premises. (If you use part of your residence for business purposes, only that portion of your rent is deductible)

Repairs to tools, instruments, and equipment used in earning your income

Royalties paid for the use of copyrighted or patented items

Signs used—cost if the useful life is short; otherwise annual depreciation charges

Telephone and telegraph expenses directly essential to earning your income

Traveling and other expenses in earning your income. Include railroad and other fares, meals, lodgings, tips, telephone and telegraph, baggage charges, including insurance, attendance at business conventions, display expenses (such as hotel sample room costs), automobile expenses, etc.

Know how to compute depreciation of your assets for tax purposes

Computing depreciation always bothers the small businessman. Capital expenditures are not deductible on your tax return. But you are entitled to a reasonable allowance for wear and tear of property. That is called depreciation. The purpose of depreciation is to permit the recovery of the capital sum over the useful life of the property invested.

There are seven methods of computing depreciation:

1. Annual installments of equal amounts—the straight-line method. This is the most popular process
2. Amortization of costs based on the number of units produced without regard to any element of time. This is used when the assets are concerned with property which will be exhausted, as for instance, oil-well machinery
3. The job basis. This is ordinarily used when equipment has been acquired for special purposes
4. Declining balance method. This seeks to apply depreciation to the years of greater productivity of the property. The annual rate is fixed so that the depreciation is greater in the earlier years and decreases with age
5. Sinking fund methods. These generally seek by actuarial calculations to set annual depreciation amounts which, with accumulated interest, will build up the amount necessary to replace the equipment at the end of its useful life. This method is used infrequently
6. The periodic appraisal method. Experts estimate the actual depreciation that has accrued upon particular pieces of property during various periods
7. The sum of the years-digits method. This method will give you about the same results as the declining balance method. But it has one advantage: it permits you to fix your own salvage value.

In addition, the law permits you to use any other method which is consistently applied. But, such method may not, during the first two-thirds of the useful life of the property, give a greater depreciation total than you would get under the declining balance method.

Use of the declining balance method or any other method giving a similar liberalized write-off is limited to assets with a life of 3 years or more.

The Treasury always denies you the loss when you use a composite rate of depreciation for a group of assets. It insists that the composite rate includes an allowance for probable retirements. If you keep accurate records of depreciable assets, you can get your loss on retirement.

For your guidance, the Bureau of Internal Revenue has prepared a bulletin (*Bulletin F*) showing the estimated useful life of various types of property. This gives you the "straight-line" rates you can use.

How to use your standard deduction tax-wisely

Individuals in business often have an important stake in the *"standard deduction."*

It was created by Congress as a substitute for proving deductions. But to take it as a deduction for that reason may be costly in business. The standard deduction (10 per cent of your adjusted gross income or $1,000, whichever is the lesser) is in place of the following items that would affect your taxes:

All deductions that would ordinarily be allowable in determining your net income except business deductions

Any credits for tax-free covenant bonds paid at the source and foreign taxes or taxes paid to United States possessions

You do not have to substantiate your standard deduction. You get the allowance whether or not you had the costs.

The standard deduction is in place of only part of your deductions. Some of them are not included in it. Most important, you are allowed your entire business costs as deductions to determine your adjusted gross income. If you are in a business, you get your adjusted gross income by subtracting from your total income:

All your ordinary and necessary costs to conduct your operations

All rent, interest, taxes, losses, contributions, and other costs directly connected with your business income

It may be important to know exactly how you compute the last item. For example (as in many of the professions) some of your costs may be in part personal and in part business. Under this rule it becomes highly important to many people to get a proper split. When you use the standard deduction, the usual rule is that the higher the business deductions, the greater will be the total deductions. That is because you reduce gross income by business deductions to get adjusted gross income. Then you compute a standard deduction on that adjusted gross income.

Obviously it is tremendously important for some people to find whether they are in a trade or business. If they are, they may get far more deductions than they would ordinarily claim.

If you have expenses in the production of rents or royalties, you need not worry whether you are in a trade or business. Your costs are treated as business expenses.

How you can get the greatest advantage from income splitting

You want to know all about "splitting income" when you consider the advantages of not incorporating your business. (The same rules apply to partners' income.) The "splitting" accomplishes all that a full partnership with your wife can give you.

Married couples now have a tremendous advantage by "splitting income." The "splitting" affects business income as well as all other income. The tax savings can be substantial. All you have to do to get them is: be married at the close of the tax year; and file a joint tax return.

The way to get your reduced taxes is simple. All you do is to file one tax return which *both you and your wife sign.* That becomes a joint return. You are not required to do this. But you must do it if you want the tax savings. Under the law you find a tax for a married couple this way: you add up the husband's and wife's incomes; then you reduce the total by all your deductions and exemptions. This is divided in two. Your tax is then figured on this, and then multiplied by two. That gives you the total tax by the husband and wife.

The tax you pay on a joint return is paid in one sum. It is not divided in half and each half paid by one spouse. The obligation to pay the full amount is placed on both spouses. Either can be called upon to pay the entire tax on the joint return. And when a husband pays the full tax he is not considered to have made a gift to his wife. There is no gift tax imposed upon him for paying his wife's share of the combined tax.

Filing a joint return does not penalize you if the income is over $5,000 and you want the standard deduction. You can now deduct 10 per cent of your combined adjusted gross income but not more than $1,000.

If your wife dies, you may still get the advantages of split income in both of the two years following the year of her death.

A joint return, to get the tax saving, may be filed by a husband and wife in all cases—except when—

Each has a different tax year. Married couples should use the same year in reporting. Only then can you split income. You can easily get permission from the Treasury to change. This bar to joint filing does not apply when your tax years begin on the same day, but end because of

the death of either or both spouses. A wife who has never filed a tax return may elect to use her husband's tax year as her first tax year. Then they can file a joint return.

Either is a nonresident alien at any time during the tax year.

They are legally separated under a decree of divorce or separation at the close of the tax year. Then husband and wife must file separate returns, and each is entitled to one exemption. The husband cannot get an exemption for his divorced or legally separated wife, even if he contributes all her support.

Is it always cheaper to use this new method of "splitting income"? Yes, in most cases. There are a few instances in which it may cost you some tax. You'll have to do the figuring if you have such elements as—

Capital losses in the sale or exchange of property
Net capital loss from an earlier year
Gains and losses from the sale of business property
Medical expenses paid by each spouse when each has income

There may possibly be other cases. Remember that you compute the income on a joint return by accumulating the income and deductions of both the husband and wife.

How to find whether it is tax-wise to operate as a partnership or a corporation

Businessmen who are alive to tax opportunities may be able to overcome economic disadvantages.

It is all-important to seek tax economy when you organize. For example, the rate on small corporations is considerably less than it is on the larger corporations. If you can do it, then, it is highly advisable to have small units.

Should you run your business as a corporation or a partnership? No rule of thumb can be given. The answer depends on many points. Here is how you go about finding the answer in your case:

Compute the estimated future yearly incomes of the business and yourself

Then figure what salary the corporation (assume a corporate form) would pay you and what dividends, if any, it would pay you

Then compute the tax for both the corporation and yourself

Now figure again what your tax would be if the partnership form were used

In both cases cover a series of years. Then make your comparisons

Here are some points to bear in mind in making your decision:

Remember that you are guessing future incomes and that individual tax rates may go lower.

Consider closely the double tax (on corporations and then again to you as dividends when you try to get the corporate earnings out). This burden is eased partially by the dividend exclusion and credit rules.

But note also that you may control the dividend policy of the corporation. You may minimize double taxation by liquidating or selling the corporation in a poor year when little tax will be due. Then you would only pay a 26 per cent tax on your long-term capital gains.

If the corporation has a substantial loss and then dissolves, you may get the benefit of a double "deduction." The loss carryback gives the corporation a tax refund. The stockholders get a loss on dissolution.

You may never liquidate during your entire lifetime. Then the cost basis of your stock to your heirs will be increased to the value at death. Subsequent sale or liquidation will result in a tax on proceeds only in excess of this increased value.

Your business may be growing for a number of years before you attain a normal level of operation. It is then unlikely, if you use the corporate form, that you will incur double taxation. You may be able to avoid paying dividends. Thus you can build up a comfortable surplus at low tax cost. If you used the partnership form, you would have paid a tax on all earnings throughout the entire growth period.

Perhaps reasonable salaries will use up the income of the corporation. This is often the case in small corporations. Here you might as well have all the benefits of the corporate form. Then no tax cost is involved.

Do not use the corporate form where income is largely to be from capital gains or tax-exempt income. Here is the reason. When you pay out this income in salaries and dividends, the prior sources of the income are immaterial. The distributions are fully taxed regardless of the origin of the income. But the character of this income does not change where the partnership or single proprietorship form is used—it remains capital gain or tax-exempt.

Do not use the corporate form where you expect losses and you have substantial personal income. In noncorporate forms these losses can be offset against your income.

Transactions with your fully owned corporation may result in taxed gain to you though a loss would be disallowed. If you are a sole proprietorship there is neither gain nor loss.

Tax advantages of a corporation

The tax on individual proprietors or members of a partnership is high. The tax on a corporation may be much lower. Cost of operation of a corporation may be less than conduct of business by means of a partnership. Much depends on the dividend policy and on what are determined to be reasonable salary payments.

Other advantages of incorporating your business are—

Stockholders who are employees may be included in profit-sharing or pension plans of the company

Certain corporations engaged in foreign trade or in other ventures have special tax benefits

Death benefits up to $5,000 can be paid tax-free to beneficiaries of a stockholder employee

Only 15 per cent of dividend income is taxed to the corporation. Such income is not subject to full normal and surtax paid by partners

The corporate form may facilitate saving income and estate taxes by gifts to children or to a family foundation

Members of a family may be stockholders without many of the burdens and restrictions of family partnerships

Perhaps you can avoid dividend payments to stockholders and reduce the double tax

Reopening of the partners' tax years is possible in the Treasury examination of partnerships. That is a serious disadvantage in a partnership

Corporation stockholders can often control the dividend processes. Therefore they can dictate the *year* they will get income. They might often select the most favorable year. Control of the dividends by corporate holders permits *averaging* of stockholders' income over a long period

The owner will have a capital gain when his corporation is liquidated

The owner may be able to liquidate in a year when he has losses to offset the gain from liquidation

If the owner dies, his estate can liquidate with no income tax because the value of the stock at his death will be its basis

A new corporation is a new taxpayer. It can choose its fiscal period, accounting methods, etc.

You get a postponement of taxes due by a corporation. Under pay-as-you-go the individual and partner pay in the year income is earned. The corporation pays in the next year. That gives you the income tax due as a base for financing a corporation

Corporations may get an immediate refund if they sustain a net operating loss. They may reduce the tax due for their prior year if they have losses in the current year. Partners must wait a year to get the same treatment, since they pay as they go

Tax advantages of a partnership

The advantages of a partnership are many. The net tax cost may often be less in a partnership than in a corporation. The corporation distributes its profits in the form of dividends. These are also taxed to the stockholders; *i.e.*, there is a double tax on the same earnings. Partnership earnings are not taxed twice. There is only one tax on each partner's share of the profits.

Corporations are penalized by a tax if they accumulate earnings without

distributing them to the owners. The partnership can accumulate its earnings at will. Other partnership advantages include—

You decide how to divide profits among your partners without regard to investment. You can even do it at the end of a year

Partners can deduct their share of partnership contributions (up to a possible 30 per cent of their adjusted gross income), while corporations are limited to 5 per cent

Partners can also take their share of tax-free interest as exempt income instead of as taxed corporate distrubutions

Capital losses of partnership businesses reduce capital gains of individual partners in preparing tax returns. This is not true in the case of corporations

Income (for example, proceeds on sale of property below cost, proceeds of life insurance, canceled debts, etc.) may be exempt to the corporation. But it is fully taxed when distributed to the stockholder. That is not so with a partner

Earnings already taxed increase the cost basis of the partner in his company. That is not true of the stockholder

There is often very great opportunity for manipulation of the profit and loss with payments in kind *in* and *out* of partnerships

If the owner is also employed by the corporation he may have to draw a salary in loss years in order to justify its reasonableness in other years. Thus, he will have taxed income although the business does not show a profit

Long-term gains are taxed at only 25 per cent to the partner, and to the corporation. But they lose their identity when paid as dividends by the corporation. Then they are taxed at ordinary income tax rates after the reduction for the dividend exclusion.

Partnership losses can be offset against personal income. This can produce the carry-over and return of prior years' taxes

Partners in community-property states should be sure to check their own state laws. They usually get a decided advantage in operating as a partnership rather than a corporation

Capital gain treatment varies. An individual is taxed on 50 per cent of the long-term profits over short-term losses. That may give a tax of less than 25 per cent. That is not permitted corporations. They pay a 25 per cent tax (same as individuals) on the difference between 100 per cent of the long-term gains and short-term losses. That may make a lot of difference in a given case

There is likely to be difficulty in tradings between a stockholder and his corporation. These problems may not arise in transactions between a partner and his partnership

Partners can deduct the carry-over of partnership capital losses up to $1,000 a year. This is not permitted to corporations

Retention of funds for development is not dictated by tax considerations

How you can get corporate tax advantages without incorporating

A new tax-treatment election has been given small businesses. These new provisions will eliminate the effect of the Federal tax laws on the form of organization adopted by certain unincorporated businesses. This is accomplished by allowing certain proprietorships and partnerships the option to be taxed as corporations.

If you expect to use the election permitting proprietorships and partnerships to be taxed as corporations, you should know these rules:

1. It applies only to a business enterprise where either—
   Capital is a material income-producing factor (the operation of the business requires a substantial inventory or a substantial investment in plant, machinery, or equipment) *or*
   Fifty per cent or more of its income is derived from trading as a principal or from brokerage commissions from selling real property, stock, or commodities
2. Partnerships with more than 50 members cannot qualify for the election
3. No proprietor or partner may be a nonresident alien or a member of a foreign partnership
4. The election has to be made not later than 60 days after the close of the year for which the election is first made. The election is irrevocable unless there is a change of ownership of 20 per cent or more

But note this well: The enterprise is subject to the corporate tax on earnings, accumulated earnings, and the alternative tax for capital gains. It is considered to be a corporation with respect to operation, distributions, and sale of an interest. And a proprietor or partner of an enterprise taxed under this election cannot participate as an employee in any qualified pension and profit-sharing plan of the business.

For the small, growing proprietorship or partnership, it may pay to hold off the election until a later year. The corporate rate is not graduated (except on the jump for income over $25,000). So, even though the corporate rate may be lower on the top dollar of business income than the highest individual rate on the same dollar, the graduated individual rate may produce a lower effective tax because of the averaging of the individual rates.

Take a two-man partnership with business income of $100,000. Assume reasonable salaries are $25,000 for each. On a taxable partnership, business income will bear a $40,600 tax. As a partnership taxable as a corporation, current tax (individual and corporate) is $35,000. But that leaves earnings in the corporation subject to a future minimum tax of $7,500 as capital gains. So total tax (current and deferred) is about $2,000 more if the election is made. And, if the business suffers a temporary reverse so that income for a year drops, splitting earnings with a taxable business entity would mean even less in current savings.

Know the tax pitfalls in changing the form of your business

Use your CPA when you change the form of doing business. It is often a very complicated business. Be sure you do not lose a lot in the change.

Many advantages will be lost to the new business when you get its assets—and it loses its identity.

They include loss of the very important net-operating-loss carry-over. And the basis for depreciation gain or loss may be changed by the transfer. Certain income, exempt from tax to the other company, may be taxed to a successor; for example: recovery of bad debts for which no tax benefit was received; life insurance processes. Seek advice of your CPA to avoid these losses.

If you are changing *from a corporation to a partnership,* you can make the change this way:

Form the partnership first
Transfer the corporate assets to it
Then dispose of the proceeds secured to the stockholders
And dissolve the corporation

Or you can—

Distribute corporate assets to the stockholders, who then—
Form the partnership

Each of these methods may result in different legal and tax problems. Sometimes this change gives a tax advantage:

Stockholders take the assets at fair market value. They pay no more than 25 per cent on their gain in liquidation. Sometimes fair market values are higher values than the corporation cost. Then stockholders might get immediate deductions at much higher rates than the corporation.

This may be particularly helpful if inventories have risen. The corporation might have to pay ordinary income taxes on sales over cost. But the stockholders get the right to sell them free of tax by paying 25 per cent of fair value in liquidation. But here you have to watch out for the collapsible corporation rules, which may hit the distribution as ordinary income. Here the advice of your tax counselor is needed. Of course, there may also be a step-down in values as a result of a liquidation if inventory and other assets are worth less than the cost basis to the corporation.

Your liquidation will give rise to a capital gain or loss. It will be a long- or short-term gain or loss, depending on whether the stock was held for more or less than 6 months.

The amount of the gain or loss on which the stockholders are taxed is the difference between the fair market value of the property distributed and the

cost of the stock to the stockholders. Value will include any fair value of the goodwill of the corporation. You may have to pay a tax on that value, even if it is not an asset on the corporation books.

If you are converting to a partnership, be sure to review with your CPA the problems of partnerships. Your setup may be taxed as a corporation because it may have the characteristics of the previous corporation.

And if you are converting to a partnership with members of your family, be sure you understand the rules covering partnership interests created by gifts to members of the family. Recognized family partnerships are easy to form. The rules are covered earlier in this chapter.

In changing *from a partnership to a corporation,* there are some common methods to proceed:

The partnership is dissolved, and the individual partners exchange their share in the partnership for the stock of the corporation

The assets of the partnership are transferred to the corporation. In exchange, the corporate stock is distributed to the partners. In this step you can probably avoid tax liability on the exchange. Check this problem with your tax adviser.

Sometimes it may be advisable to create a tax by the transfer. The partner may have some advantage in taking a loss, due to depreciated value of the property, on his individual return. Or it may be highly advisable to pay a tax on a capital gain. This increases the basis of the property to the corporation. That may reduce subsequent computations of income or gain. If you want to create a taxable gain or loss on the exchange, you may be able to do it if you make the transfer so as not to have a tax-free transaction.

Tax overpayments because of lack of knowledge can destroy a business

The high percentage of failures among new business concerns is attributed to management failures—bad financing, failure to understand the sales market, unfamiliarity with problems of supply or competition, and very often to the *overpayment of taxes.*

The small businessman who engages a competent doctor as a matter of course for his personal health is often too overconfident or too suspicious to call in competent counsel for the health of his business. Far too few seek such aid.

Management service and accounting procedures that accountants can furnish may be the difference between continuation or shutting down for many new concerns close to the borderline of the 30 per cent that fail the first year.

5. HOW BEST TO HANDLE YOUR CREDIT AND INSTALLMENT SALES

If credit is granted and the customers pay their bills promptly, you normally can increase sales to steady, satisfied customers. But if customers are allowed to charge amounts beyond their ability to pay promptly, it is a drain on your capital. It may result in bad-debt losses.

The small businessman must know the advantages and disadvantages of extension of credit to his customers. Factors to be considered are—

Larger working capital will be needed if the small businessman extends credit. His capital must be sufficient to carry the accounts receivable, to buy stock, and to pay for operating expenses. With active, paying accounts, most of a store's credit will be outstanding from 4 to 6 weeks. But most of the store's bills will be due on the tenth of each month. When determining the capital needed, the small businessman must provide for this delay in collecting money owed him.

In some cases, it may be possible for the small businessman to increase his business substantially through extension of credit without adding materially to operating expenses. Where this is true, he may decide to grant credit. But he can limit charge accounts, insist upon prompt payments, and try to keep on hand sufficient cash to meet bills as they fall due.

Sometimes the determining factor should be the kind of business. In some small businesses it may be possible to operate successfully on a strictly cash basis. But in others, such as an electrical appliance store, the very nature of the business may make it impractical to insist always upon the full purchase price in cash.

Occupations and incomes of customers should influence the merchant in his choice of a cash or a credit policy. In a community made up largely of farmers or ranchers, a small businessman may have to give credit until his customers have sold their crops or stock. Lower-income, but steadily employed, families often find it necessary to charge purchases from payday to payday. Buying on credit is the preferred method among many higher-income families also. They like to charge purchases, then pay for all of them at the end of the month.

Competitors' policies sometimes govern. If competing retailers do a credit business, it is certain that they have found it a means of increasing sales. Undoubtedly, the policy has been a profitable one for them, or they would not continue it.

What are the advantages of selling on credit?

The small businessman who sells for credit gains a number of advantages. First, he is able to build up a clientele of regular customers. The reason for this is that cash customers are anybody's customers. Charge customers are customers of record. Other important points are—

Charge customers usually are not as concerned with the prices of goods as are those who pay cash. They tend to buy a higher quality of merchandise, and they frequently buy more of it

Credit is an accommodation to customers. Because of this, charge customers generally have a feeling of good will toward the store

Goods can be sent on approval to customers

Charge customers provide an excellent mailing and promotion list

Adjustments can be made more easily

A more intimate relationship can be built up between the customers and the store

Along with these advantages come disadvantages, which the small businessman must also consider:

Capital is tied up in merchandise charged by customers

Credit adds to the interest charges on money borrowed by the merchant

No matter how efficient the merchant's collection system, some losses are bound to occur. Credit customers may purchase beyond their ability to pay

Credit customers have a greater tendency to return goods than cash customers

Credit adds to the cost of operations, since an account must be maintained and monthly statements prepared and mailed

Know the principles of a sound credit system

Credit can be either an asset or a liability to a businessman. Properly controlled, it can increase sales and bring a steady, well-satisfied customer. Handled in slipshod manner, it can cause an overinvestment in accounts receivable, large bad-debt losses, and certain failure of the small business.

If you give credit, you should understand and apply the six principles of a sound or controlled credit system:

1. *Applicants for credit are investigated thoroughly.* The first step should be the investigation of the customer, or an interview with the applicant, or both. How you do this is fully discussed on another page.
2. *Decision is made carefully.* After completing your investigation, you should make a careful decision on the application. In this decision, you

should consider the applicant's character and credit record, his earning power and ability to pay, and his capital and property. Along with these factors, you may have to take into account the personal background of the applicant—his social standing, general reputation in the community, and business career.

3. *Limit on credit is set.* You should not decide to open an account without considering the dollar amounts involved. The amount of credit granted to a customer should be based largely on his income, and will vary, of course, with the type of business.
4. *Terms of payment are defined.* As a safeguard against bad-debt losses, you should have a definite understanding with the customer as to the credit terms. Stipulate that payments are to be weekly, monthly, or on paydays. In some cases monthly terms are satisfactory. In others even longer terms can be used successfully. What should be avoided in all cases is the selling of goods on credit without you and the customer knowing the exact time payment is expected.
5. *Account is controlled.* From the day the account is opened, you should control it carefully to see that the customer upholds his part of the agreement. If credit is on a monthly basis, permit no further charges on an account if it is not paid by the end of the month in which payment is due. Others insist on giving personal approval to additional purchases on such accounts. *How much* credit should you give?
   - Some hold that the limit should not exceed 30 per cent of the customer's monthly income
   - Others, more conservative, prefer to start the account with a smaller limit, increasing it as the credit relationship with the customer proves satisfactory
6. *Delinquent accounts are followed up promptly.* When a customer has not paid his account within the specified time, suspend the account. No further charges should be made until the account is paid or a new agreement reached. It is dangerous to allow old balances to be carried over indefinitely, or beyond a reasonable period. The main reasons for this are—
   - The older an account becomes, the harder it is to collect. When merchandise is no longer new, the customer feels that he is paying for a "dead horse"
   - Customers have greater respect for the merchant who handles his business according to agreement
   - Customers with unpaid accounts, fearing the merchant will ask for the money, avoid his store and buy elsewhere
   - Carrying accounts beyond the agreed time increases the merchant's operating costs

In deciding whether to suspend the account, considerable judgment and discretion must be used. In smaller stores, personal contact with customers is usually frequent. In the case of old customers with good credit records,

definite arrangements may be made to pay overdue balances, instead of placing them on a cash basis. The amount overdue can be set up as a separate account. The customer can arrange to make regular payments on that past-due balance, along with the payment of current bills. For instance, if the customers owes $40, it may be arranged that he pay $4 a week for 10 weeks. Once a new agreement has been reached, the businessman should insist on its observance.

When a customer is able but unwilling to pay, you should act decisively—perhaps under competent legal advice. The customer should be warned that the account will be turned over to a collection agency or to a lawyer unless paid by a certain date. Having issued the warning, carry through with it. If a small business does not, it will acquire the reputation for being easily put off.

How good record keeping will aid you in credit sales

Record keeping is not a remedy for bad credit practices. But record keeping can provide the information that will warn the retailer in time if his credit business is getting out of control. Record keeping cannot run a credit business. But a credit business cannot be run without record keeping.

What should your records tell you?

How much extra credit you are in a position to offer. You get this from the total amount owned by customers, compared to what you set as the limit your business can stand. You cannot do this without records.

If charge sales during a week (or other period used to check) are more than collections, it may mean that the charge business is increasing. Or it may mean that collections are poor. If charge sales amount to more than collections the following week, and the next, it may be a positive danger sign. There should be a close relationship between collections and charge sales. The danger sign is when collections lag behind charges week after week. Your records should tell you where you stand.

Your records should compare charge sales with the amount owed by customers on a given day during each week. That gives an idea of the age of the accounts. If terms are weekly, the outstanding accounts at the end of any week should approximate the amount of 1 week's charge business. Customers do not always pay their bills on time. For that reason the amount on the books may be in excess of the charge sales during the credit period.

How to conduct retail credit interviews

The interview should be exploited to the fullest, to cement the best of future relations. Its importance cannot be stressed too strongly. Many times delinquent accounts can be traced to incomplete interviews.

Tact is necessary at all times in handling actual or prospective customers, but especially during this interview. Some customers are sensitive about direct questions. They set up a mental resistance. It may injure the desirable good relations between store and customer. Indirect questions, in a conversational way, will more often produce the desired results.

A New York Department of Commerce check list says you should cover these four points during this initial interview:

1. *Who is the applicant?* The applicant's identity is of utmost importance to prevent mistakes so that the customer may be served promptly and efficiently. The full name, as well as wife's or husband's name, is necessary to identify the particular applicant. It avoids confusing the account with those of other members of the family or with other names with similar initials. The telephone number is also important for purpose of communication. The directory may show no telephone. The applicant may be rooming or boarding. Telephone contact is valuable for collection purposes and to verify orders on occasion. Having a telephone may bear on the question of credit standing and ability to pay.
2. *Can the applicant pay?* The ability to pay is essential information. It is necessary to learn the applicant's earning capacity. The name of his employer, his position, and length of time he has been associated with the firm are all important facts. If his present employment has been of a relatively short duration, his former employment record should be obtained. This should give the interviewer a good picture of his earnings. If not, the customer should be questioned concerning his other income, such as pension, rental income, and earnings of other members of the family. The ownership of real estate, whether encumbered or clear, will indicate the strength of his capital position. Commercial bank information is of importance, particularly if based upon loan experience with the customer. If his savings account is substantial, it is another indication of his ability to assume credit obligations.
3. *Will he pay?* It is not difficult to determine the willingness of the applicant to pay. Local credit bureaus have records indicating how individuals have paid their bills in the past. How the customer has paid accounts with other merchants in the past is very important. Therefore, it is well to obtain the names of firms which have already extended credit courtesies to the applicant. They can be checked for his credit history. Some firms extend credit on paying habits alone. This is usually sound practice where an adequate record of prompt payment has been established. In this connection, it is in order to give a word of warning about the "pet reference." A credit applicant often refers to one or two stores where he has maintained prompt payment but purposely refrains from mentioning others where his accounts are delinquent. By clearing all applications through the credit bureau, you obtain records of slow accounts, suits, judgments, bad checks, domestic troubles, and other derogatory items.

4. *What credit terms should be given?* An important phase of the credit interview is to have some definite understanding with the prospective customer regarding his estimated monthly requirements. This aids the credit manager in his control of the account. It also establishes a tactful opening for discussion with the customer in the event of unusually large purchases or special requests for extended terms. It is important that the customer understand the type of credit account he is obtaining.

How to check a customer's credit

When the interview is over, the application should be investigated through the local credit bureau. It is an integral part in the extension of consumer credit. The bureau verifies the information contained in the application and checks the bank and credit references. It adds such other pertinent information as is found on file, such as legal records, claims for collection, newspaper clippings, and other information relating to the applicant's responsibility.

The credit bureau acts as a clearinghouse for credit information in the community. It provides a dependable source of information on the credit of local customers. The records reveal the actual trade or credit experiences of individuals with banks, retail stores, material dealers, finance companies, physicians, dentists, or hospitals. Credit bureau files include such highly important public records as judgments and deeds, mortgages, chattels, and conditional sales.

In cases where the bureau also operates a collection department, this provides much information of value to the bureau files.

Any reputable merchant, by arrangement with his local credit bureau, may obtain these important services. Since all credit bureaus are affiliated with the Associated Credit Bureaus of America, Inc., information can be exchanged on a national scale.

The completed report will show whether the credit applicant has means sufficient to assume the obligation and pay it according to the terms.

If there is no credit bureau in the community, the merchant may obtain information from other stores and businesses, the applicant's place of employment, his bank, and his neighbors.

When the information developed in credit investigation does not clearly suggest a decision, certain other factors might be considered before opening or declining the account. They might be—

Favorable factors	*Unfavorable factors*
Good record of parents	Moves frequently
Married	Changes jobs frequently
Pays rent promptly	No bank accounts
Owns home	Slow in paying rent
Stable employment record	
Maintains checking account	
Maintains savings account	

How you can earn profits from installment sales

Properly managed, installment selling can increase a retailer's sales and profits. Handled haphazardly, it can cause an overinvestment in accounts receivable, large losses, and perhaps eventual failure of his business.

What goods are sold on the installment plan? As originally used, installment selling was limited to durable or "hard" goods, such as refrigerators, ranges, home furnishings, and musical instruments. These have a long life and a relatively high value. They can be repossessed and resold by the retailer if the customer fails to make payment.

In recent years, the installment plan has been broadened to include many nondurable or "soft" goods, such as clothing, blankets, home furnishings and accessories, and sporting goods. Soft merchandise is often of low value and either cannot be readily repossessed by the retailer or is not worth repossessing.

What is the cost of installment selling? When you do any form of credit business, your capital investment naturally must be larger than if you sold strictly for cash.

If you sell on the installment plan, this investment must be considerably larger than when your credit sales are of the regular or open charge-account type. Money tied up in installment sales is "frozen" for a long time unless arrangements are made to transfer the installment contracts to a sales finance company.

Many small businesses do this in order to cut down on their capital requirement. Thus they concentrate on their sales efforts.

If a retailer's volume of installment sales runs to $1,000 a month and his terms call for customer payment of 10 per cent down and the balance in 12 monthly installments, he has tied up over $5,850 of his working capital in a year's time. That assumes all accounts are paid on time.

When he allows his customers a longer period in which to make payment, his working-capital needs also are increased. If he allows payment over 24 months instead of 12, the working capital required to carry the sales is practically doubled, increasing to over $11,250.

What are the principles of successful installment selling? Three principles are of great importance:

The down payment should be large enough to make the purchaser feel that he is the owner, not merely the renter, of the merchandise

If the article is repossessable, the unpaid balance on it always should be sufficiently below resale value to protect the retailer from loss if repossession becomes necessary

The monthly payments should be large enough to increase the cus-

tomer's claim to the article faster than it will depreciate from time and average use

The down payment required by retailers on purchases of hard items varies considerably. That may depend upon the type of merchandise. They run from less than 10 per cent to 33⅓ per cent or more of the total price. A payment of about 10 per cent is the most common requirement.

Retailers generally ask a higher down payment on soft merchandise. It decreases in value more rapidly through use, wear, or changes in fashion. The minimum down payment is usually about 20 or 25 per cent.

Granting installment credit to your customers adds in several ways to your cost of doing business. For example—

- You must pay clerical help to maintain records of installment sales
- You may have to borrow money, at interest, because much of your own capital is tied up in installment sales
- You must pay for legal services when collecting from customers who are unwilling to pay
- You inevitably must bear some bad-debt losses

In order to make your installment business pay for itself, you should place a carrying charge upon time-payment sales. It should be based neither on guesswork nor on the charges made by your competitors. It should be determined by a thorough study of the cost of handling your installment credit.

When making an installment sale, you should explain carefully to the customer: the amount of the carrying charge; the saving that results if his down payment is increased and the period of the contract shortened. If a contract is paid out before maturity, you should make an equitable refund on the carrying charge.

To sell successfully on the installment plan, you need a sound, effective credit system.

The fact that you can repossess any "hard" articles you sell does not lessen the need for close control over your credit sales. Repossessions seldom are profitable. Time, labor, and legal expense are involved. In many instances, too, repossessed articles prove unsalvageable.

Good installment credit operations require that you investigate new customers carefully. Before accepting a new installment customer, you should be certain that he is a good risk. The mechanics for this step are the same as in other retail credits.

From there on, good management moves this way: *It has sound terms and explains them carefully.* It is essential that you be certain that the customer understands the *rate and manner in which he is to make payments* and the *length of the contract.* In addition to explaining carefully the terms to the customer, and as a further guard against misunderstanding, you should send him a written statement of them.

You should have a prompt and *consistent follow-up on installment payments* that become past due.

In one effective method, used when contracts are on a monthly payment basis, the first notice is sent to the customer 1 to 5 days after due date of the delinquent payment

If payment is not made, second and third notices or telephone calls are made at intervals of 10 days. If the account is still unpaid after the third notice, a collector is sent out

When a customer falls behind in a payment, take action before the next payment is due. The customer who cannot make one payment seldom will be able to make two at the same time.

If the purchaser of a repossessable article misses a payment, but has made a number of previous payments satisfactorily, you should attempt to get the past-due payment or obtain a new arrangement before the next installment is due. Repossession, in a case such as this, should be only a last resort. When a customer misses his first or second payment, however, you generally should obtain the payment or repossess the merchandise. Customers who miss either of these payments usually are poor credit risks.

When the purchaser of a nonrepossessable article fails to make a payment, you should either obtain the payment or reach a new understanding before the next payment is due.

If a customer's installment payment is past due, you should *suspend his credit privileges* until payments are again being made promptly. The reason for this is obvious. The customer who cannot pay his present installments certainly could not pay additional ones.

Instead of merely threatening a customer who has fallen behind in payment or repossessing the merchandise, you often will do better to propose a plan by which matters can be straightened out. Perhaps a friendly talk will be enough.

But if the customer is truly in financial difficulties, you may have to change the terms of the contract to make payment easier. You may reduce the size of the installments and lengthen the period of the contract; or extend the life of the contract, adding the past-due installments, plus a fair charge, to the end of it. Once a new agreement has been made, you should enforce its strict observance.

Occasionally, of course, you will have a customer who is able but unwilling to pay. When this occurs, you should *act decisively*.

In the case of durable merchandise, this action can be either repossession of the merchandise or a suit to obtain judgment. That always should be a last resort. But it never should be delayed when it is obviously the only solution

When the merchandise is nondurable, your collection efforts must be to press the customer for payment. Or turn the account over to a collection agency or a lawyer

How to check the credit standing of a businessman

There are many sources of information concerning a customer's business. Especially important are the general mercantile credit agencies and the special mercantile agencies dealing with your particular trade. Others include—

Suppliers that deal with your customers
Credit bureaus operated by trade associations
Data collected by your salesmen
Information secured from banks
Data obtained from the customer himself
Financial services such as Standard and Poor's, Moody's, or Dun & Bradstreet's

The general mercantile agency has much information. Its rating reference books, special reports, and credit-checking agencies will help. The difficulties in dealing with the general agencies are these:

Reports are generally not current unless you request special data
The mercantile agency cannot secure financial information in all cases
Reports do not cover your customers' credit completely enough so that you can find out the exact status of the accounts
The agency cannot furnish exact ledger transcripts to permit you to have detailed information
It does not cover the personal side of the individuals or give a generalization as to their standing in trade circles

Sometimes you can use the *special mercantile* agencies. If there is such an agency in your own trade, you will find it of great use. As a general rule, their reports are somewhat prompter than those of the general agency. On the other hand, they often have too limited facilities to permit thorough analysis.

You will probably find that an exchange of credit information with *other suppliers* is likely to give you the best analysis of the current status of your customers. It is one of the best methods of gathering opinions about the management, character, and quality of your customers' business. Generally, the information is more up to date than that normally secured from general agencies.

Use your *salesmen* to secure all possible information. You will get results if you instruct your salesmen on how to—

Obtain current financial condition
Study the character and trade practices of a customer
Avoid excessive purchasing or overstocking by the customer
Aid the customer in the development of his business, particularly in extending sales and goodwill
Furnish customers with exact information as to the manner in which your firm will deal with them
Adjust any difficulties that arise between your firm and the customer, thus gaining further knowledge of how much credit you ought to extend

But be careful of the usual difficulties when you permit salesmen to become credit reporters. Normally, salespeople are difficult to instruct. They simply do not understand the need for credit information. Too often their compensation depends on the volume of sales produced, and they may extend credit too freely. Sometimes they are unwilling to offend customers by the type of inquiry you may require. Too often they do not like to be bothered with credit information. On occasion they are decidedly antagonistic to reducing their volume and are not cooperative. But in a lot of cases they get results that are very important.

Sometimes you can use *local attorneys* to considerable advantage. A simple request to local counsel for a report on a credit status may be of considerable value. Use local attorneys particularly to discover if liens, claims, judgments, or actions are pending against the debtor. Sometimes reports by local attorneys are prejudiced in favor of their neighbors. And too often compensation is insufficient to permit a proper study.

You may find that *personal interviews* with proposed customers yield first-rate credit information. Use the meetings to encourage complete expression by the customer about his prospects, finances, and policies. Use them to formulate personal impressions of the risk and as a basis for analysis of financial statements. Interviews at the customer's store or office are most effective in securing first-hand impressions of his management and business practices.

Get a *financial statement* of your customer, if that is possible. If you do, be sure you know the full use of the false-statement laws. He may be subject to prosecution if: he makes a false financial statement; he gives it to you intending that you should rely on it for credit purposes. Know, too, the Federal mail statutes that make it a crime to send a false statement through the mails.

How to evaluate a business for credit purposes

Extend credit only on the basis of present ability to pay, but make credit policies flexible. Expand credit in recovery phase of business cycle; contract when recession is imminent.

Your first rule in the determination of the amount of credit to extend is the customer's character and ability. You should—

Evaluate characters, reputations, and business abilities of those directly concerned with conducting the business. Are they conservative? Venturesome? Intelligent? Have they high living standards?
Take salesmen's credit information with a grain of salt—don't forget they want to earn commissions

Good management also studies collateral circumstances:

Determine whether the credit requested is unseasonable or otherwise unusual for the type of business concerned
Check on the credit prospect's location and, generally, business and other relevant conditions in that neighborhood
Note whether credit information is readily furnished and if answers are to the point and unevasive
Check on other enterprises of prospective debtor; do they enhance his credit risk?
Avoid extending too much credit in one territory or creating competition with others of your customers in that territory
Check the highest credit line at any time to a particular customer with what he wants now, under current business conditions
Check hazards of fire and other disasters to see whether insurance is adequate

Good management in small business requests periodic financial statements, preferably those certified by reputable independent accountants. It uses an efficient and complete printed form in credit-checking routine, avoiding the more costly individualized correspondence.

It may do a lot of other important things:

Participate actively in the work of various associations compiling credit data
Devise a method of automatically "flagging" an account for attention when approaching its credit limit
Look for and analyze distress signals, such as part payment being made, or notes offered in payment
Know in advance what guaranties or securities may be required, should the circumstances suggest their need
Know the business of the customer—its hazards, its personnel, its sponsors, and its links to other enterprises
Check on outside mortgages, liens, or control on the management by other creditors or interested parties
Understand the nature of the business of the customer. If the extension is for a new venture or side lines, find out if they are hazardous

See whether the customer's business is subject to unusual price cutting and excessive risks
If the customer is in a town with one industry, determine its condition before extending too much credit
See if persons alleged to be in charge of management are actually figureheads to cover incompetent backers
Find out if financial houses or banks have representatives in the business, and why
Understand the connection of the officials of the company with other organizations
Ask for copies of the corporate bond indentures and mortgages to find out what assets can be relied on in the event of difficulties
See whether the company is tied in with any other companies likely to affect the risk
Get the facts of any bankruptcies or receiverships mentioned in the history of the credit prospect
Be guided by whether or not others have ever had to institute legal action for collection
Gather all available particulars about any fires in the history of the credit prospect
Search public records for judgments and other liens that may not have been mentioned in the customary sources of credit information
Find out if there is any contest by insurance companies or underwriters about fire losses

How to analyze your customer's financial statements

Make sure the statement received reflects most recent conditions. See that it is received by mail, which gives full advantage of the penal laws.

Be sure the statement is based on fact rather than on estimate. Place more reliance on statements that are certified to by independent, reputable accountants. Read their certificates and comments.

Ascertain whether or not the statements are recent and contain information in sufficient detail to enable proper analysis. You should insist on sufficient detail. Weak spots are obscured by generalities and broad classifications. Also ask that supporting schedules be furnished on important items, such as a schedule and analysis of receivables, investments, inventories, or creditors. Be sure your data offers comparisons with preceding periods and helps to discover trends.

Many essential facts do not customarily appear on financial statements.

For example, it is up to you to find out: what contractual commitments the customer has at higher-than-market prices; if the customer has unfulfilled contracts for sales at too-low prices.

It is up to you to inquire if "*cash items*" such as i.o.u.'s, payroll advances,

and loans to officers and employees are contained in what is represented as *"cash on hand."* Study these points, too:

Find out whether the customer's money is on deposit with a bank that also carries an outstanding loan of his business. In such a case the money is usually encumbered directly to the extent of that loan

Inquire how much of the available cash is earmarked for more or less immediate payment of wages, dividends, bonuses, loans coming due, and purchase commitments or expansion programs

See if the cash position is adequate for anticipated business requirements

Check on unusually large cash balances to see if they are indications of inefficient use of capital

Check to see if cash is really available or is held by subsidiaries, affiliates, trustees, or agents

Check on unusually low cash balances to see if assets such as accounts receivable or inventories will have to be pledged for losses to the disadvantage of general creditors

Accounts receivable on the customer's statement must be studied in this way to show what they are worth:

Have them grouped into age groups, and compare them with credit terms

Ascertain with some definiteness what portion of the receivables may be classed as "good," which can be counted on for payment when due, and which are "bad"

Find out which accounts are past due, and why

Check credit of each substantial past-due account as well as unusually large current accounts. Check to see if the sales to them are bona fide

Be vigilant as to whether or not some accounts have been sold or assigned, without being so indicated

Eliminate from the total of receivables any accounts that represent goods shipped on memo or consignment or accounts for goods sold but not shipped; these charges do not constitute proper receivables

Look into the treatment of goods shipped to branches, which should be shown as inventory rather than as a receivable from the branch

Set up reserves for discounts and allowances, if they are not created by the customer. View with disfavor any attempts to obscure loans to officers and employees by including them with trade accounts receivable. Also check the ratio of sales to accounts receivable for several periods. An increasing return reflects a favorable business trend.

Study of *notes and trade acceptances* receivable includes the inquiry to find what portion is fully negotiable and what portion is restricted, what notes are worthless and should be written off, and a great many other steps; for example—

Find out if the practice is to hold notes until maturity or to discount or sell them

Ask, in case of notes discounted or otherwise pledged, what the pledger's contingent liability amounts to, because of indorsements or other forms of guaranties

Break down the total notes receivable into three classes—

Those originating directly from sales

Those in payment for open accounts

Those representing renewals of old notes

Insist that notes from officers and employees be clearly shown separately; scrutinize dates, and compare with earlier statements to spot renewals

Find out whether presence of notes receivable is usual in the business. Or is it indicative of laxness in collecting, or bad accounts?

Segregate trade acceptances from notes. Review them on their own merits. Trade acceptances arising out of original transactions are usually considered better than trade notes.

Use your findings to determine what amount should properly be shown under current assets and what should be shown among noncurrent assets. Beware of notes that may be stuffed in to inflate current assets. In that category look into notes that may represent unpaid stock subscriptions.

Many steps ought to be taken about *inventories* before their value is judged. That may include these steps:

Inquire whether inventories are kept under control by means of accurate and detailed stock records

Guard against the inclusion, in inventories, of goods received on consignment

Ascertain if slow-moving, obsolete, or shopworn items are regularly eliminated from the inventory accounts

Inquire whether all items of inventories have been billed for and paid or liability included in accounts payable

Make sure all items sold and billed, but retained for customer disposition, are omitted from inventory

Insist that the method of evaluating the inventories and any changes in method be clearly set forth

If method of inventory valuation used was unsatisfactory—cost, lowering of cost or market, last-in–first-out—adjust valuation accordingly before proceeding with analysis

Ascertain whether inventories are pledged or encumbered

Estimate liquidity of inventories with consideration of seasonal changes, priorities, freezing orders, or other factors

One of the important problems is to see that finished goods and goods in process are costed under approved tenets of cost accounting. Cost used

should not be in excess of market price, less the cost of selling and distributing.

Important, too, is computation of significant ratios: inventories to current assets, to total assets, to sales, to receivables, and to purchases. Then comes the job of comparing these ratios to the corresponding ones of prior periods. Reasons for any considerable variation should be reviewed. And the ratio should be reviewed with averages currently prevalent for successful firms in the industry or trade.

Don't assume *investments* are cash. Obtain, whenever possible, a detailed schedule of investments. Then examine the quality of the investments to see if they are speculative. Other important tests are—

Check current yield on cost and on market values
Find if the securities are free or pledged
Inquire why they are held
Calculate the ratio of investments to total working capital
Determine if funds are tied up when they should be put to use in the business, rather than in someone else's business
See if the securities are quoted in local markets and on exchanges; if not, their value may be discounted, and they should not be shown as current assets
Segregate investments in subsidiary or affiliated companies; these should under no circumstances be shown as current assets, no matter how marketable, because the intent is probably not to market but rather to hold for control
Do not include a company's own shares among current assets
Separate insurance on the lives of officers from investments; proceeds due from insurance company may be a long-deferred receivable

You should then review the *other assets* listed. See that investment in furniture, fixtures, and plant equipment is reasonably proportionate to the size of the business. See that adequate allowance is made for depreciation. Find out if fixed assets are kept in good serviceable condition through adequate repairs and maintenance.

Check whether unpaid taxes or assessments are liens that are not shown in the statement; if recent alterations or improvements are indicated, check also for possible mechanics' liens.

Be cautious in evaluating such intangible assets as patents, goodwill, franchises, rights, trade-marks, etc. Their real worth is usually in the future earning power. That may have no relation to the book value.

Point one in your study of debts is to segregate accounts payable into such natural classifications as trade accounts, loans, taxes, wages, etc. Then compare each classification with earlier statements to ascertain principal fluctuations. Ascertain the reasons. From there on you can make this study:

Look into any amounts shown as due officers and stockholders, and get all the facts on how these obligations were incurred
Investigate the reasons for past-due unpaid accounts
Make certain all known and determined liabilities are reflected in the statements
Inquire as to nature and amount of all contingent liabilities
Inquire into the status of taxes that may be in dispute, for which no liability is shown
Find out whether obligations are secured in any manner, and, if so, determine the collateral given; the pledged assets may be shown either on the asset side or as a deduction from the liability, but you may annotate it as improper to show the liability as a *net* figure
Obtain a schedule of ratios showing how current average monthly indebtedness compares with current average monthly cash collections
Determine what portion of the current liabilities relates to merchandise or materials included in inventories
Satisfy yourself as to whether loans due officers and stockholders indicate that bank credit is not available or whether the lenders have particular confidence in the business
Get a full explanation of why any past-due obligations have not been paid

Get a clear understanding of how *long-term obligations* were incurred. To what extent has borrowed money been used to acquire fixed assets? How is it proposed that such borrowings be repaid? Then look to these points:

If there is a mortgage indebtedness, find whether or not the mortgagor is "on the bond" and has "personal" liability to pay. If not, only the encumbered property can be looked to for liquidation of the debt
Inquire into release clauses, contingent modifications, and, of course, date of maturity, interest rate, and amortization provisions
With bond issues, determine in what manner they are secured, *i.e.*, by mortgage or by lien on anticipated future income
Ascertain the principal terms and relevant facts of agreements, indentures, and prospectuses concerning a bond issue
Compare the total authorized bond issue against the total issued and outstanding. Inquire if additional issuing is contemplated
Obtain the terms and provisions of any sinking funds that have been established. Determine if sinking-fund provisions have been lived up to
Look into any conversion provisions in all instruments representing outstanding indebtedness. Attempt to estimate the effects of exercising the conversion privileges
Find out who holds the outstanding securities and how they were distributed

Be cautious of *"contingent"* liabilities. They may become actual if the contingency occurs. Determine the extent and status. See if they are ade-

uately disclosed in the financial statement. Determine, specifically, whether ie company whose statement is being analyzed has indorsed or otherwise uaranteed any obligations of others. This includes negotiable instruments old or discounted.

If the statement is that of a business other than a corporation, inquire individual firm members or partners have become contingently liable by ndorsements and guarantees on obligations of others.

Do not overlook damage claims, lawsuits, and disputed assessments. They ften are not recorded on the books until suits are settled.

Ascertain if the business is liable on a mortgage bond in a case where the ortgaged property has been sold to others subject to the mortgage. Attempt to estimate the probability of a deficiency judgment.

Composite balance sheets and income statements of successful firms of pproximately the same size as that of the prospective customer may help. Many such figures are now available. Good management often checks the gnificant ratios on composite statements. Then it compares the ratios of ie prospective customer and seeks an explanation of unfavorable variations.

An especially sensitive indicator is the ratio of current assets to current abilities. When this ratio falls continuously, it is a sign of deterioration. Another important ratio is that of net worth to total debt. If this ratio connues to fall, it may indicate disaster.

How to collect overdue accounts

The small businessman must be informed about the causes of the denquency, not guess or follow stereotyped routine.

Then he must determine with intelligence whether slow rehabilitation or ecisive action is more desirable. Collection often takes special aptitudes nd knowledge. They include—

- Insight into the behavior of people; a knowledge of psychology
- Ability to be persuasive and stimulate others to action
- Capacity for following through; absence of indecision or tendency to dawdle
- Ability to write letters and use telephone with firmness and conviction, yet without loss of respectfulness
- Cold logic of mind but friendly manner and sympathetic disposition
- Knowledge of the ruses and tricks of delinquents

Collection pointers. A sale beyond the ability to pay means the unhappy irth of a bad collection problem. But suppose you have done it. Now ou must collect. Perhaps you can use these time-tested aids:

Call upon your debtor personally, telephone him, or write him. The size

of the claim, the relative danger of loss, the cost involved are all factors in determining which to do

Get in writing, by responsive letters if possible, or by taking security notes or other instruments, admission of facts that eliminate possible claims, defenses, or counterclaims

See if it is advisable to charge interest—sometimes this gets action

Offer some bargains; this may induce a debtor to clean up his account

Use the telegram; it spurs and suggests action and successfully competes for attention

A person-to-person telephone call may do the trick

Sometimes a good heart-to-heart talk after a good dinner is effective

Shrewd inquiry to debtor's bank sometimes impels action

Sympathetic help often encourages more effort to pay up. Help the debtor save face; have a whipping boy handy. This often helps you get paid

Get him to start with a token payment, to start collection ball rolling

If he is sluggish, prod him first gently, then become increasingly firm, retaining his goodwill for future business. If he is on brink of disaster, don't dally; act swiftly to save him if you can

If he is dishonest, "beat him to the punch" by frustrating his designs, with or without cooperation of other creditors. Don't "pussyfoot." If confronted with bad account, get collection department under way

Make your plan of debt payment an accomplished fact. Exact promises, and press him to fulfill them

Get collateral security, notes, dated checks, sureties, or other feasible assurances of payment—perhaps return of merchandise or extra allowance is acceptable

Never be satisfied with signed papers that merely presage a business funeral; get signatures of responsible persons

Watch debtor's pattern of action after plan of payment is placed into effect to see if he is mulcting the business, giving preferences, etc.

One collection practice that might work is offer of prizes to salesmen on basis of points, for collections on old accounts. The older the account, the larger the number of points. Other tricks that have worked include:

Write the debtor saying you guess he is withholding payment to get your whole sheaf of collection letters—you are sending them all at once to get the payment now. Enclose a set of such letters

Send a debtor a hat or cigar with a personal note explaining that you (the collection man) bet your boss this account would be paid by this week and lost

Telegraph, telephone, or write the debtor that his account is about to be sold to a tough collection agency in his community but before subjecting him to merciless methods will he arrange to settle

Offer a special gift to debtor if payment is made this week

Use funny, plaintive, and figurative cartoons, pictures, etc., stuck to collection letters, such as baby crying, a sphinx, etc.
Legal-looking forms demanding collections, personally served or delivered by registered mail, may be effective for installment collections. Check if this is legal in your community
Offer to get some orders for delinquent customer to reduce his stock, etc.
Send huge letter or scroll that in oversized letters requests payment
In your collection letters "talk turkey" about Thanksgiving time, have heart-to-heart talks around Valentine Day, and stress golden rule about Christmas season
Send checkerboard to debtor telling him to make next move

Much has been said about *collection letters.* Experts list these rules:

Don't write anything that you will be sorry for later
Avoid bad taste, insults, recriminations, and defamation
Be friendly, yet firm and confident in tone
Use impersonal forms when prodding is needed
Turn complaints into goodwill by being helpful
Where appropriate, show that effective collection policy is followed to keep up quality of service or product at minimum prices for all customers
Remember that a soft answer turneth away wrath. Whether to be solemn, humorous, angry, or gentle in tone depends on the personality of the recipient as well as the occasion for the letter

Experts urge that letters be easy to answer. Perhaps stamped envelopes should be enclosed, or notes already filled out.

Know the important laws affecting your collection methods

The small businessman and his lawyer ought to have a couple of sessions talking about the way the law affects collection efforts. We got these notes that way:

The acceptance of a *promissory note* from a debtor, particularly if it is indorsed by a third party, will usually prevent you from taking action until maturity of the note. Extensions induced by fraud will not be binding. An extension by you may release indorsers, sureties, guarantors. If you are using *trade acceptances*—

See that they are *called* trade acceptances. The face of the documents should contain a statement that the debt arises from the purchase and sale of merchandise
Make them definite orders to pay, without any qualifying conditions
See that they are "accepted" in writing across the face

Don't use the words "per invoice of" or any other restrictive language beyond that absolutely necessary

See that acceptances mature not more than 90 days from the date of presentation

Here is the way to make full use of the *false-statement laws and the Federal mail statutes:*

You can prosecute if your customer made a false financial statement, intending that you rely on it for credit purposes, and you parted with value relying on it

The statement should be in writing. Consider the use of financial statements for your customers, so printed that when folded they make their own mailing envelope. That furnishes proof of mailing required when false statements are used

When statements are received by mail, preserve the envelopes. Note on them the date received and the signature of the person receiving them. Have these witnessed and attached to the statements themselves

Statements of opinion are not actionable. They must be statements of material fact, misrepresentations as to—
- Amount and nature of assets and liabilities
- Basis of valuing assets
- Character of assets and liabilities
- Profits made
- Amount of sales and terms of sale
- Percentage of profit on sales
- Amount of goods produced
- Nonexistence of liens and assignments

See that all blanks are filled in on your statements and make inquiries as to guaranties, indorsements, and other contingent liabilities. The debtor's failure to mention them may not be actionable

Get new statements periodically. Statements are generally effective for a reasonable time only

Make use of public statements—those to stockholders, articles of incorporation or partnership

Statements made to mercantile agencies are generally treated the same as though made directly to the creditor. But in replying on these statements, consider their age and find out which statements were made by the debtor and which by the agency

Enter into a stipulation with the debtor that he will notify you of any material unfavorable changes in his financial condition

If you know of any facts that might reasonably throw some doubt on the truth of the debtor's statements, you should make appropriate inquiries before you rely on them. If you know that the debtor made some material false statements, don't deliver merchandise or part with value

relying on them. Do nothing that might be a waiver of your right of redress

In dealing with partnerships, the firm signature is generally equivalent to the signature of all the partners. As a rule, it is not necessary to exhaust the firm assets before proceeding against the individual partners. But you can proceed against a retired partner if you have not received proper notice of his retirement and if you had been doing business with the firm prior to that date. Be careful to note whether you are dealing with a limited partnership. In that case, not all the partners are personally responsible for the firm's debts.

If you have a judgment against an *individual partner,* you may levy against his interest in a partnership but not against the firm's assets. The partnership's creditors will get priority over you with respect to the firm's assets, and generally, the reverse is also true—you will get priority over them with respect to the partner's private property.

Check the laws as to marshaling of assets between firm creditors and individual creditors of partners. A partner has no authority to transfer to you any of the firm's assets in payment of his personal debts. If he does, the firm can generally recover the property transferred. Your lien will attach only to the surplus remaining after the affairs of the firm have been settled.

In transactions with social clubs, hospitals, cooperatives, and other *unincorporated associations,* make sure the party you deal with binds the other members. See whether the obligation incurred is within the scope of the organization's purposes.

When dealing with *corporations,* make sure the person you deal with can bind the corporation. And remember these points:

Stockholders who have not fully paid for their stock are directly liable to the corporation for any unpaid balance and therefore indirectly liable to the creditors

Directors of corporations are personally liable to creditors when corporate assets have been depleted through unlawful acts committed with their knowledge or consent, or there is illegal payment of dividends or gross mismanagement

Officers of corporations are personally liable to the stockholders and the corporation for loss or damage arising out of: any acts beyond their powers, unless later ratified by the corporation; losses resulting through their neglect, mismanagement, or wrongdoing; breach of trust

In taking an *assignment* of your debtor's accounts receivable or other assets, see whether any future accounts are included. If so, check whether the law in your state permits the assignment of such accounts. Find out

from counsel how much "dominion and control" you may safely allow the debtor to retain over his accounts.

Is it necessary for you to notify the accounts of the assignment? Does the law require your debtor to file a notice of intention to assign and to maintain certain records, etc.? If so, check to see that he complies.

If any of your claims are, or can be, secured by a *guarantor or surety,* see that the guaranty is in writing. Here are some points:

- If the guaranty is given after the debt has been incurred, it should be supported by good legal consideration
- Make it a practice to notify the guarantor that the guaranty has been accepted. Before accepting a guaranty—
  - Check the right of the guarantor to act as such, particularly in the case of corporations
  - See that the surety is advised of any facts which might deter him from acting as such
- Notify the guarantor promptly of the debtor's default. If there is more than one surety, be careful about discharging any of them. If you do, you may also be discharging the others. Here are some rules:
  - Don't make any change in the terms of the obligation or otherwise alter the guarantor's risk without his consent
  - Don't grant the debtor an extension of time without the guarantor's consent
  - Don't surrender any collateral security deposited by the debtor
  - Don't discharge the principal debtor unless you also want to discharge the guarantor

In trying to *collect past-due accounts,* don't use a post card if you are threatening legal action or reflecting on the debtor's character or conduct. Don't use envelopes or displays obviously intended as a reflection on the debtor's character. In *writing or speaking* to or about your debtors, see that what you say or write doesn't go beyond the truth, even by implication. Don't repeat slanderous or libelous statements originally made by others, nor say or imply that the debtor is bankrupt, dishonest, has no credit, etc.

If you must make such statements, see that no one but the debtor hears or reads them. This includes your own stenographer and the debtor's secretary, clerks, associates, etc. Don't take the attitude that you are through with a matter when it has been turned over to an attorney for collection. You should know the legal remedies available in order to help your attorney. Your knowledge of the particular facts will frequently be of great assistance. Particularly, discuss remedies with counsel in cases where—

- Title has passed but you still have possession—you may have a lien
- Title has passed but possession is with public carrier—you may have special rights

Title has passed and delivery has been made and the buyer refuses to pay in accordance with your agreement
The buyer refuses to accept and pay for the goods
The buyer breaks the contract before you finish

You might discuss with your attorney attachment proceedings (*i.e.*, a preliminary levy on the property of the debtor) when the debtor—

Is a nonresident of the state and the property to be attached is within the state
Has left the state with the intention of defrauding his creditors or preventing legal action against him
Goes into hiding
Has removed or concealed his property
Is about to do so, for the purpose of defrauding his creditors
Has secured goods from the creditor by fraudulent means, such as the making of a false financial statement

You should know about *third-party* proceedings under which money or property due your debtor is applied on your claim when the debtor has an established right to the money or property, or a third party has possession of the property by means of a fraudulent transfer.

Avoid proceedings in *bankruptcy* if you can find other and better remedies. See if another plan will realize more money for you than is possible through bankruptcy. You then will keep an honest debtor in business and might make up any losses through subsequent dealings with him.

Do you want to give your customer a chance to save his business or get a fresh start in a new business, free of debt and without the adverse publicity and effect of bankruptcy? You have a choice of a *private agreement* between the debtor and his creditors without the intervention of the courts, or with the assistance and protection of the courts. In these cases, study with counsel—

Alternative procedures provided by other Federal and state laws, such as assignments for benefit of creditors
The possibility of using the Federal bankruptcy law (Chandler Act) itself
Use of the equity and chancery courts

6. HOW TO FINANCE YOUR BUSINESS

Your business needs capital for two main purposes—to acquire fixed assets and for working capital. The latter is the operating capital you use for salaries and wages, purchasing supplies and inventory, and extending credit to your customers.

There are three ways in which you can obtain capital:

1. Through *investment* by yourself and others interested in the business. This should be sufficient to secure the fixed assets which cannot be financed upon long terms at reasonable rates of interest. It should also provide an important portion of your working-capital needs—if possible, the initial or minimum working funds, so that loans need be used for only seasonal or expansion purposes.
2. By *borrowing* money from one of many places which are reviewed in this chapter. These might include: *government* sources like RFC or Federal reserve banks (our government is very conscious of the need to help small business today and is constantly shifting financing plans and laws to give aid); *insurance brokers* (life insurance companies are often anxious to make loans; your broker may be able to check through for you); *full use of the "business opportunity" columns of your paper*, a very useful source for financing (keep reading the advertisements of those with funds to lend). Other sources include: *extending your terms* with creditors; *getting advances* from your customers; *taking negotiable paper* from customers as soon as you can get it, and a lot of others discussed in this chapter.
3. Through *retaining profits* in the business from year to year.

Should you use capital stock or long-term obligations for equity capital?

How should you determine whether to secure permanent capital by issuing capital stock or some kind of long-term bonds or notes? You should seek capital through stock—

If you want to avoid debts; you can raise what you need from sale of some of the many kinds of stock described in Chap. 9

If the economy is heading for a period of deflation

If the maturity date or the fixed charges will be a burden that cannot be met

If your capital position and credit are weak

Obtain capital by long-term bonds or notes, borrowing only when you are certain to be able to refinance or pay the loan when it matures if the effective long-term interest rate is below the probable rate of future earnings. But use these pointers on the kind of permanent borrowing you do:

Borrow for short term only for working capital. See that debts mature as they can be paid

Borrow for long term only for financing fixed assets, land, and buildings essential for profitable production. The term of such indebtedness should approach the productive life of those assets

Give no mortgages or pledges if doing so harmfully and substantially affects your short-term credit

Don't overcapitalize. It may cause: extra interest cost, thus raising costs; extra tax burden on issuance and in annual payments to the Federal and state governments; depression in value of other classes of securities of the company.

In determining the amount of stock, avoid the pitfall of issuing too much or too little. Recognize the disadvantages of overcapitalization:

If the stock is watered, it will sell below par and the company's credit rating will be low

It will be difficult for the company to secure additional capital

It will result in a large tax liability on organization and state franchise tax

It may lead to difficulties through failure to maintain proper reserves and the eventual evaporation of the "water"

What are your sources for equity capital?

The individual private investor is the most important. Your job is to find one willing to purchase an interest in your business. That may be a relative, a friend, or an outsider—or one of the sources on the first page of this chapter.

While a new partner or investor is often the best solution for a business needing capital, ask your lawyer if the kind of securities you sell him make it advisable to use care in selecting him. Maybe you should not take a man into your business just to get more capital. You must work with him and share the control of your business with him. You must be sure about his personality, temperament, honesty, and business ability.

If you deal with a private investor or promoter, ensure protection and goodwill on both sides by making certain that all papers are drawn by an attorney whom you can trust.

If you are seeking to increase your company's permanent capital, you may want to place your problem before an investment banker. It is not generally easy for the small concern to acquire equity funds by selling

securities. But sometimes a banker can arrange a private issue of securities or a small public issue. Issues of $300,000 or less, and those offered purely within your state, do not require registration with the Securities and Exchange Commission, though you must notify them in advance.

In seeking to raise money from investors, you should ask yourself these questions: Will it cost me more in the long run to deal through an investment banker, with a reasonable commission? Or will it cost me more to deal directly with individual investors, who may try to get a large interest rate on the money they put up, and perhaps a sizable block of stock as well?

Often you will decide that it is better to work through an investment banker. He already knows people with money, and he knows how to interest them in promising ventures.

Your banker, attorney, or business associates may be able to recommend a nearby investment banker to you. You can also write the small business committee of the Investment Bankers Association in Chicago or the National Association of Securities Dealers, Inc., in Philadelphia.

Choose your investment banker not merely by reputation. Consider knowledge of actual accomplishment, especially in your type and size of business.

Rules for finding the working capital you need

How do you make your plans for working capital? First, keep thinking of contingencies that cannot be forecast—strikes, fires, unusual competition, unexpected tax assessments. Next, try to be able to take advantage of inventory-building opportunities. Ample cash will permit this. Think, too, of these points:

You should have enough cash so that you can take all your discounts and keep up your credit to the highest basis
You should not have so little leeway that you can't do special promotion work when you feel that a little investment will do a lot of good
Your bank is likely to be far more receptive to working capital excess than to fix capital of unusual size—it helps your quick and current financing
You should constantly watch for the opportunity to convert inactive or obsolete assets to cash

But if you have an excess, remember—

It is a wasted reserve—banks pay no interest today
Keep it guarded carefully from foolish investments in unneeded inventories or activities outside your own field

Look out for waste in handling your money when you have once felt that you are very prosperous

How do you determine the amount of working capital you require?

Do it by studying your cash requirements in the rise and fall of your inventories and accounts receivable.

Ascertain the point of largest investment in inventories and accounts receivable. At that time, the amount of all your current assets, minus your current liabilities, is the minimum working capital required. Current assets are your cash, inventories, marketable investments, and good receivables.

Some working capital may be borrowed. But what cannot be readily and surely borrowed must be invested capital.

If you cannot raise it that way, you must plan your business on a smaller scale.

Before you seek outside aid for working capital, cut down your need for financing. See if any of these ideas will help you:

- Speed up sales and collections to procure needed funds (sales, cuts in prices, special events, etc.)
- Increase the turnover of inventory
  - Keep the inventory timely and modern
  - Standardize and simplify as much as possible
  - Avoid retailing to satisfy whims
  - Keep enough control to clear it up regularly
  - Cut down the buying—put it on a hand-to-mouth basis
- Get the most advantageous terms in purchasing
  - Perhaps some part of your buying can be on consignment or deferred payment
- Consider changing the method of selling to, say, installment deals or any other process that will give you customers' negotiable paper for discount
- Maintain collections at the greatest possible rate
  - Make sure the collecting process is diligent and modern
  - Check your customers in advance
  - Keep the follow-up forceful, courteous, and productive
- Withal, keep a reasonable balance in extensions to customers, if you propose to move your inventories
- Think also about the possibilities of extending your terms with creditors; getting advances from your customers; selling any assets you do not need in your business
- In manufacturing, see if you can cut down the period of production as much as possible. Keep the jobs moving from raw stock into sales as quickly as possible. In periods of stress, cut out experimentation, and concentrate on more profitable work. Watch waste and possible use of by-products

Cut down dividends or any other stockholder drain
Sell any investments or assets not pertinent to your operations

Here is Rule 1, to tell you when you need more working capital: You need it when you can use it to cut costs or increase efficiency by more than the cost of obtaining the additional funds.

If you are thinking of using loans to expand your business, bear this rule in mind. Also avoid getting out of line on the ratio of fixed assets to inventory, current assets to current liabilities, net investment to total indebtedness.

Notice that the rule doesn't say, anything about the rate of interest. In some cases it will be bad business for you to borrow funds even if you can get them for 3 or 4 per cent. In others it will pay you to obtain additional credit, even if you have to pay substantially more for it.

The only time you should violate this general rule is when your company runs into a serious but "temporary" financial reverse. Then you may have to borrow purely to extricate yourself. But make sure, if this should happen, that the "temporary" financial reverse is really temporary. It might be that there are some new developments afoot—such as the redesigning by your competitors of their products—that can wreck your business unless you make quick adjustments to meet them. When an individual firm is in difficulty, more than financial pump-priming is generally necessary to redeem it. Some businesses fail simply because of a lack of capital. Failures result more frequently, however, because of a lack of some management "know-how."

The best way to get your bearings is to think of a loan as you would a piece of equipment, such as a commercial refrigerator or a lathe. It may pay you to put a new lathe in your shop or a new refrigerator in your store; it may increase efficiency and output. In the same way, it may pay you to install another business tool, called loan capital or credit. The interest charge is the amount you will have to pay for the use of this important tool.

It is poor economy to skimp on money for your business. The most successful businesses use plenty of fixed capital and operating money and use it efficiently. They must have it to operate successfully.

Don't hesitate to borrow, so long as you can put the money to efficient use and pay it back when due.

Here is Rule 2, to tell you when to borrow: Borrow when it will protect your credit.

Do it, too, so you can take all your discounts, keep up performance of contracts, purchase materials at attractive prices, meet your current expenses when collections are not keeping up, maintain facilities during dull seasons, and cover normal seasonable expansion.

On the other hand, if the need is to purchase plant equipment, effect major alterations, meet old obligations, pay interest or other charges on obligations, or pay taxes, then loans are possible, but they require careful consideration.

Shop for your borrowed money

You are always competing with other concerns in designing, producing, or marketing products and services, or some combination of these. You also compete in obtaining the funds with which to operate and expand.

Capital is vital to the future of your business. The company that gets what it needs, on the most favorable basis, has a great advantage.

It is hard to give specific figures on what you should pay for loans. The charges vary tremendously (all the way from 1 per cent per annum for commercial paper houses, which make loans solely to large corporations, to 42 per cent per annum for some small-loan companies.) That depends upon the type and size of borrower, the type and size of lender, and other factors. This chapter lists a great many possible sources for loans. As you study them, use these pointers to get the best deal:

"Compare before you buy"; that is, compare the prices quoted by all those alternative sources which may be able to supply the type of loan accommodation you need. Try to do this without needlessly offending your regular suppliers of credit.

In comparing prices, always reduce each to a per cent per annum effective interest rate on the average amount of the loan. There are many different ways of quoting interest. The situation is further complicated by investigation charges, minimum deposit requirements, service charges, and collection charges on delinquent accounts. The one sure way to make valid comparisons is to reduce the total charge to this basis.

Also make careful comparisons of collateral and security requirements and any other conditions for credit.

What does the bank want to know when you apply for a loan?

Like all good selling, obtaining a business loan requires a complete presentation of the product. In this case the product is you, your managerial ability, and your business. Banks, as well as other lenders, usually require applicants for business loans to be able to show—

Good personal character and reliability

Sound business ability

Success in past business ventures or sufficient knowledge of business methods to give promise of future success

Adequate investment on the part of the proprietors

Reasonable need for the loan; reasonable probability of repayment on time and in full

Bankers expect you to give factual information which may be evaluated and verified preliminary to making a loan. Most banks have application forms upon which the information may be listed. They vary somewhat from bank to bank.

You will be able to comply with all requests for information if you organize your information and thinking along the lines outlined below.

What is the information required by banks? They usually seek the following:

How your business is organized (corporation, partnership, or proprietorship). This makes a difference in the liability feature. Lending institutions are not in complete agreement as to which form of organization they consider best

The nature of your business and when it was organized. Have there been any recent changes in your business name or nature of operations?

Personal data concerning the principal owners. For example, the age and marital status of yourself and your partners or principal stockholders. Where do you have your personal bank accounts? In what business and civic organizations do you have memberships? Do you and your associates carry life insurance? In what amounts, and who are the beneficiaries? Is any life insurance carried by you or your associates for the benefit of the business?

Business banking connections: Where does your business maintain bank accounts? What is its bank indebtedness? Is there any indebtedness other than with bankers? If the business is organized as a partnership, do the partners have any contingent debts outstanding?

How you propose to repay the loan and what its purpose is

In many ways the *purpose of the loan* is the most important feature of the loan application. The lender wants to be sure the loan will be used for a necessary business purpose. Your ability to establish that will be extremely helpful. To prove your business need for a loan, you should cover such points as the following:

Is it for a business operation of a self-liquidating character? For example, is the loan needed to finance the purchases of merchandise which can be sold before the loan is due?

Do you have orders for merchandise which will require additional working capital to manufacture?

Will the funds be used to purchase equipment having a general purpose or a specialized one?

How did you arrive at the amount of the loan requested? Is it the minimum necessary for the intended purpose?

Your bank will want to talk about your *prospects.* You want to be ready to—

Give a brief account of the future of your business in terms of such questions as the probable demand for its product or services, and the presence, absence, or prospects of competition
Show what will be your probable future ability to obtain raw materials or supplies of merchandise and what the costs will be
Show what you think future price levels will mean to the valuation of your present inventories
Point out any other items which will shed light upon your business

Your bank will, of course, ask you for a *balance sheet.* In it, you will list your business assets and liabilities as of some recent date—and for comparative purposes, the same information for the previous year. In doing that—

Show proper reserves for depreciation
State how your inventories have been stated. Ordinarily they should be valued at cost or market, whichever is lower
Give the dollar amount of accounts considered past due or doubtful, or show an adequate reserve for bad debts

Your bank will also ask for a summarized statement of last year's sales, costs of doing business, and net profit before income taxes. At least one previous year must be shown for established businesses. If several years' data are offered, it will be helpful. This should include information on how much you and your partners are drawing from the business, or how much dividends have been paid in recent years.

If yours is a *new business,* you will not have much of the foregoing information. What should you collect?

Have some ideas about how you will use the financing to operate your business with success
Prove that you have built up a reputation for paying your obligations when due
Show you have had adequate business experience in this or a similar line of effort
Show you have sufficient financing of your own to warrant a lender taking a reasonable risk in advancing part of your financial needs
Perhaps show you have on hand unfilled orders or business prospects of a character giving reason to believe that you can produce sufficient income to repay the loan

Aids in choosing the bank best for you

It is important to choose your bank wisely. Here are points to watch:

If you can, choose a banker who is willing to assume a risk, providing there is a reasonable assurance of repayment

Choose a progressive banker—one who is alert to current industrial trends, willing to make loans for new products and more efficient processes. He knows that, in the world of rapid change, risk is a matter of careful analysis, not merely of traditional soundness

Choose a banker who is interested in your line of business. Some bankers tend to specialize in certain types of businesses and may not be especially interested in your line

Choose a banker who has confidence in the future of your community and thus is willing to invest in it

Make sure the bank is the proper size for your business, taking into consideration its lending ability under the statutes. Some banks are forbidden by law from investing money in your business—they can advance money only when assured the loan will be repaid within a short time

See whether it can buy securities for you or take them for safekeeping if you want this done

Find out if it has vault services

Be certain that its officers are accessible for conferences with you when you require them

Find out if its deposits are guaranteed under the Federal statutes

See if it discounts satisfactory customers' notes

Find out if the cost of collecting out-of-town checks is acceptable

Find out if the bank makes an excess activity charge, *i.e.,* a charge for all checks issued in excess of a certain number

See if it will willingly furnish you the data you need concerning your customers or trade

Make sure the bank is so located as to—

- Facilitate moving your funds for deposit
- Cash checks for the office or employees
- Cash payroll and petty-cash funds at a minimum risk
- Be of assistance to employees in savings accounts and other matters

Your community banker, who is more often than not a small businessman himself, may be more receptive to you than one in a large city. On the other hand, large banks sometimes charge rates below those of their smaller competitors. Your only answer here is to compare.

Many banks are now setting up special small-business departments. These are helpful, so long as the rates are favorable.

Don't change a seasoned banking relationship without good reason; on the other hand, don't remain dependent upon your present connection if you are sure you can do better elsewhere—not only now, but over a period of time.

How to set up good relations with your bank

Once you have chosen your banker, consult him frequently. Visit him at his office and invite him to visit you at your plant or store. Offer to show him around. Freely explain your plans to him, especially if they involve expenditures out of the ordinary. Don't try to conceal difficulties from him. It is part of the banker's code not to betray confidences. Don't be secretive; mutual frankness is the first basis of good banking relations.

To keep your banker's respect and to run your business efficiently, take these five steps:

1. Make sure your accounting system really tells you how things are going. You should know what it costs you to produce everything, to sell everything, to maintain everything
2. Supply your banker with an annual audit of your company's books by CPA's. This service is one of the best investments a small business can make. It may also prove beneficial from a tax viewpoint. You should understand your CPA's report thoroughly. Be ready to offset the unfavorable points disclosed. If the audit indicates an unsound financial condition, a poor credit policy, a poor turnover, and a poor trend in earnings, be ready to show your plans for revision and expected savings

   Don't overstate your case—show the bad side, too. Get it on record when the bank is considering your loan
3. Construct a financial budget showing your company's plans for the future. The plan for each department of the company should be reduced to dollar-and-cent terms in this budget. Include in the budget your best estimate of sales, expenses, capital expenditures, needed operating capital, and credit and capital needs to be met by borrowing. The bank wants to see that you maintain that type of control and to know where you are going
4. Be ready to furnish concrete evidence of the peculiar nature of the business, particularly the credit ratings of the customers and the normal ratios in the industry. See Chap. 2 for the kind of ratios to assemble. Be sure your bank also knows—

   Trend of the business

   Status of your company in the industry, its goodwill and competitive position

   Conventional terms of sale in the business

   Production methods and other techniques used

5. Do not abuse a line of credit. When it is granted for seasonal purposes, do not try to use it for equipment. It is bad business to use short-term money for such things anyway. On the other hand, you should not hesitate to use it whenever it is profitable

What kind of bank loan can you get?

If you establish and keep up good banking relations, you ought to be "in the running" for most types of loans. If your bank thinks it cannot make the type of loan you want on its own, it may be able to do so through arrangement with others with which it maintains a correspondence relationship. What kind of loans can be made?

Character loans. A character loan is actually an "unsecured loan," made without collateral, and based upon the applicant's production, sales, and management ability; earning capacity; business standing; and general integrity.

When your banker has confidence in you, he is likely to arrange short-term character loans for you as you need them. A better way may be to ask for a line of credit. It is an advance commitment by your banker to lend you money up to a certain maximum. Usually it is on a revolving basis, so that you can have more than one loan out at a given time as long as you keep within the agreed-upon maximum. This will also save you in interest cost in comparison with a single loan equal to the maximum sum required at any one time.

Term loans. A term loan is one which is repayable, according to an agreement between lender and borrower, over a period of more than 1 year. The maturity period averages around 5 years. Sometimes it runs up to 10 or 15 years. Life insurance companies and industrial banks, as well as commercial banks, make long-term loans. Advantages are—

These loans are one of the best ways to make up for equity capital deficiency in your business. The duration of the loan can be arranged to fit your special circumstances

The repayment schedule may be scaled to fit your earning power. In this way, you may acquire needed assets and pay out of earnings

Loans on accounts receivable. Small businessmen often make wide use of loans secured by the pledge of accounts or notes receivable. Your banker may make such loans. They are on either a *notification* or a *nonnotification* basis:

On the notification basis, the bank not only tells those who owe you money that it is lending to you on the security of your receivables, but it also undertakes to secure payment directly from them. Some states have laws

requiring notification, either always or wherever necessary to protect the loan

On the nonnotification basis, the bank does not tell your debtors anything about the loan. They remit to you in the usual way and you to the bank to pay back the loan. You may prefer a nonnotification loan, even though the charges on it are usually higher on account of the greater risk to the bank

Loans secured by warehouse and field warehouse stocks. If you own readily salable goods—anything from eggs to hardware—which are in a commercial warehouse (or can be put there for the purpose), your banker may be willing to lend you money, using as security a receipt issued by the warehouse certifying that it holds the goods.

Or you can sometimes store the goods on your own premises, under a field warehousing arrangement. In this case you can have a commercial warehouse, or some other third party, take formal custody of the goods and issue a warehouse receipt which the bank will use as security for the loan.

Some banks also make warehouse and field warehouse loans on stocks of raw or semifabricated materials.

Equipment loans. Manufacturers of durable equipment can probably get a loan using installment notes receivable as collateral, or can discount these notes with a bank or finance company.

If you are purchasing new or secondhand equipment, you can probably finance the purchase by a bank loan secured by a lien on the equipment. When considering such a purchase, compare the terms offered by the equipment manufacturer, distributor, or other seller with the cost of buying for cash and financing the purchase through an equipment loan from your bank —unless, of course, you are in a position to pay spot cash. Equipment loans often run for 2 or 3 years, or longer in the case of heavy equipment.

Other bank loans for business purposes. Commercial banks make a number of other kinds of loans which differ mainly in terms of the type of security offered:

Your banker will probably accept the cash value of a life insurance policy as security for a loan. Loans against life insurance are increasingly frequent

Chattel mortgages are a common form of security for bank loans. The chattel mortgage is an assignment of title covering something you own—refrigerators, machinery, or other movable personal and business property—to the bank, which uses it as collateral for the loan

Some national banks make first mortgage loans on improved business property. State banks are also allowed to make mortgage loans according to state statutes. Mortgage loans are related to term loans but are generally for longer periods. Savings banks, trust companies, savings

and loan associations, and insurance companies also make mortgage loans

A loan may also be obtained on the strength of some other type of security that you and your banker may devise, perhaps bonds or stocks you or your company holds, or on the indorsements or guaranties of outside individuals or companies having good credit standing with your bank

Other bank sources. Nearly all commercial banks have well-developed "correspondent" relations with other banks both locally and in the larger financial centers. This makes it possible for a bank to give better service and handle more and larger loans. If your bank is unable to make the size loan you request, it may offer part or all of the loan to other banks in your community or to a bank in a neighboring city. This "share the loan" policy has been useful in making possible a large number of loans which could not have been made otherwise.

Should you use industrial banking companies for loans?

An industrial bank is an organization that specializes in consumer installment loans. It gets its working capital from customer deposits or the sale of investment certificates. Many resemble ordinary commercial banks. Morris Plan banks were formerly typical industrial banks. Today many of them accept checking deposits and do a general banking business.

Note this about industrial banks:

Many states limit the *size* of cash loans industrial banks can make

The length of *time* for which loans may legally be made also varies from state to state. Typically, it is a year or two. Some states have no legal limitation

Charges on loans are also regulated by law in many states; but competition with commercial banks and small-loan companies often brings industrial bank rates down to well below the legal maximum. Industrial banks commonly quote their charges as a certain number of dollars discount per hundred. Often there is a charge for credit investigation. Some companies omit the credit investigation fee; others vary it inversely with the size of the loan. A common rate of discount is 6 to 8 per cent of the face value of the loan, deducted in advance on a per annum basis

Loans are generally *paid off* on a regular schedule. Since the loan is typically half paid off when half its term has elapsed, the "average" amount of money you have out is only about half the face value of the loan. This means that the effective interest rate (not counting any credit investigation fee) is about double the stated rate of discount, or typically 12 to 16 per cent or more

Installment loans for business purposes are, therefore, a relatively expensive way to obtain capital. Ordinarily it is not advisable to use them unless other sources of loans are not available.

But the rates vary in different parts of the country and among different institutions, so it is worth while for you to investigate the terms offered by the industrial banks in your area. They are usually listed in the classified telephone directory. Remember that in some localities industrial banks are operated as regular commercial banks.

Small-loan companies as a source of loans

Small-loan companies operate under state regulations and license and are also known as personal finance companies or consumer finance companies. Some states limit these companies to loans of $300 or less. But larger loans are permitted in other states. In addition, many small-loan companies also do a discount or sales finance business under other laws. Note this about them:

The rate of *charge* for small loans is necessarily higher than for large business loans, but rates are limited by statute and are paid on the unpaid principal balance only, without compounding or additions

Prepayment at any time is permitted without penalty

Under competitive conditions, the small-loan companies make a substantial proportion of their loans to business proprietors. Their installment service and careful help in budget planning make them useful in many situations where loans are required for business purposes.

Factoring companies as a source of loans

Factors specialize in buying outright the receivable accounts of their clients. The client—a textile manufacturer, for instance—usually relies on his factor's advice as to what trade credit he should extend. Then he sells all his accounts receivable to the factor "without recourse"; that is, the factor agrees to take any losses on the receivables he has purchased.

Most factors operate on a notification basis. A few of them do not notify the client's customers when they purchase the receivables.

Small businesses comprise a large percentage of the customers of factoring companies. In the past, most of the clients of factors have been manufacturers, mainly textile manufacturers. Lately, the factors have begun to serve other kinds of manufacturers, including producers of shoes, radio tubes, home furnishings, and metal products, and also wholesalers. Here is how they work:

Factors usually *advance* funds on a short-term basis. Generally they expect to convert the purchased receivables into cash within 30 to 50 days. They sometimes extend special medium-term loans to their regular clients

Factor *charges* include a rate of interest and usually a fee or commission. Interest rates are commonly 5 or 6 per cent. The fee or commission, which may run from 0.75 per cent to 2 per cent of the sales cashed, is designed to remunerate the factor for advising his client on the selection of risks as well as for collecting the receivables when they are due from the client's customers

Factors also frequently render other management consultant advice

Since there is usually frequent turnover of receivables, the commission may run up the effective interest rate to a considerable figure. For example, if you paid a 2 per cent commission eight times in a year, the commission would in effect be 16 per cent. But the credit and collection service rendered by the factor might be well worth this commission.

Depending upon the nature of your business and your existing credit connections, it may pay you to get information and appraisals from one or more factors. If you are operating with inadequate equity capital and are having difficulty in obtaining bank loans, you may find that a factoring arrangement will provide a solution to your problem. The interest cost will be relatively high. But adequate financing may permit a larger volume of business. The profits derived from the larger volume may be sufficient to make it possible for you to get on a properly financed basis eventually.

Commercial credit companies as a source of loans

Another source for short-term loans may be found in the concerns variously known as commercial credit, discount, or finance companies. They do not buy receivables and usually do not furnish collections service or management advice.

Commercial credit companies will usually lend money secured by assignment of accounts or notes receivable in much the same way as commercial banks, industrial banks, and small-loan companies. They will also make loans secured by warehouse receipts or field warehousing arrangements. They may lend to finance the purchase of certain types of equipment which may be used as security for the loans. Here is how they work:

The cost of borrowing from commercial credit companies is not as high as from factors because of the lower risk assumed and the absence of extensive special services. They usually compute their interest on a daily basis for the funds actually advanced. Where this policy is followed, there is no padding in the interest charge. The nominal rate is the effective rate.

As a result, commercial credit companies may be a comparatively low-cost source of funds in some situations

Like factors, commercial credit companies usually limit their loans to manufacturers' or wholesalers' receivables. Unlike factors, they operate rather widely and can be found in any fair-sized city. Their terms and practices vary materially. You should analyze a loan offer carefully

Sales finance companies as a source of loans

Sales finance companies specialize in buying installment receivables at a discount. For example, suppose you are a retail furniture dealer. You sell a piece of furniture to a customer on installment terms. You require the customer to sign an installment contract or note. You sell the contract or note to a sales finance company, which then receives the customer's periodic payments on it. Thus you receive cash for your installment sales.

Sales finance companies have grown up rapidly with the growth of installment selling. Most of them handle a variety of accounts arising from the sales of durable goods, such as automobiles, farm implements, and office equipment, as well as consumer goods, such as furniture, jewelry, and home electrical appliances. They work this way:

Some buy the installment paper "without recourse." You are not liable even if your customer's account becomes delinquent. In other cases you are partly liable on delinquent customer accounts.

Under most plans the customer deals only with you, the seller of the goods; he usually does not even know you have sold his account. But if the account should become badly delinquent, the sales finance company may get in touch with the customer direct.

Charges vary greatly. They are usually stated as a per cent per month of the original unpaid balance. You should investigate carefully the actual cost both to you and your customers. Figure your total per cent per annum charges arising from the sale of your installment paper. Then check the terms your customers would receive when buying from you, against the terms they can get from your competitors. Your larger competitors may have enough working capital so that they can offer their customers installment terms which you cannot profitably match if you have to sell your paper at discount. If you can borrow working capital at reasonable rates, you may find it wise to carry your own installment sales.

Sales finance companies are listed in classified telephone directories. Some not only discount installment accounts receivable, but also make loans on accounts receivable. Some also make loans of the personal finance company type or conduct still other types of business. Some industrial banks and other lending institutions engage in sales financing activities.

Miscellaneous finance companies as a source of loans

In addition to the private sources already mentioned, there are in many cities various other financing companies offering credit for business purposes. Many of them provide accounts-receivable loans and other working-capital loans. Unfortunately, some of them are in effect "loan sharks" charging exorbitant rates; others offer credit at reasonable prices. You will find them listed in classified telephone directories under "Financing," "Loans," and similar headings. It may be worth your while to canvass some of these concerns just to see what kind of services they offer.

Insurance companies may be a source of loans

Insurance companies often make mortgage loans on industrial properties as well as on residential and commercial properties. If you own a place of business or are thinking of purchasing one, you may be able to arrange such a loan.

Insurance companies also make term loans which resemble commercial bank term loans. As a rule, they are interested in larger loans and longer terms than most small concerns can justify. Nevertheless, it might pay you to investigate this possibility, especially if you can offer adequate security.

Equipment manufacturers as a source of loans

Manufacturers of store fixtures, cash registers and calculating machines, delivery trucks, industrial machinery, etc., offer financing plans. Under these, the purchaser of the equipment can buy on an installment basis and pay out of income. Equipment distributors often offer similar terms. Though the cost varies widely, credit of this type is often expensive.

When you are buying equipment on terms, compare the terms offered by different suppliers just as carefully as their products. It is equally important to compare the cost of buying on terms with the cost of borrowing from a bank or other lending institution and paying cash.

Wholesalers and suppliers as a source of loans

Trade credit supplied by wholesalers and other suppliers is highly important to the retail trade. Wholesalers in turn rely on manufacturers for such credit. There are several cautions involving the use of trade credit which you may want to consider.

Many companies buy from high-priced suppliers who provide extended

trade credit rather than from low-priced ones who do not. Often they never take the trouble to calculate in per cent per annum terms what the credit is actually costing them. Without knowing it, they may be paying a price that is exorbitant compared to the cost of credit from alternative sources.

Where attractive cash discounts are offered, the firm which fails to take advantage of them may in effect be obtaining a very expensive form of credit

Much trade credit is really bank credit furnished indirectly through the wholesaler or other supplier as an intermediary; the retailer or other customer may pay two charges on such credit

Trade credit relationships are sometimes used for coercive purposes. For example, a supplier may impose on those who owe him money by filling orders with inferior goods; or he may threaten to close credit if his customers try to carry competing brands

Keep your eyes open when you make use of trade credit. Do not let it cost you too much money or force you into a position of dependency on specific suppliers. If it does, you may do well to pay off your suppliers even if you have to borrow elsewhere to do it.

Use judgment in selecting your suppliers. Narrow down the number to a few in whom you can place complete confidence. They in turn will learn to have confidence in you. You can rely on their help in case of sudden difficulty.

Remember that the habit of paying cash on delivery or within a few days' time (or even advancing money to help finance a supplier—trade credit in reverse, this might be called) is one of the main reasons the big company often gets goods for less money than the small company.

Corporations seeking affiliates, branches, or outlets as a source of loans

Many larger manufacturers, mail-order houses, and the like are on the lookout for small manufacturers—especially those making more or less unique products—which they can take over as branches or affiliates. Similarly, oil companies, chain drugstores, grocery chains, and similar concerns are looking for retailers whom they can buy out, take a financial interest in, or establish as more or less independent outlets. Credit relief is often stressed as an advantage in such proposals.

Some offers would allow you to retain a measure of control over your business. Others would involve your selling out completely. Carefully weigh the loss in independence against the possible increase in financial stability.

The Small Business Administration as a source of loans

The Small Business Administration is authorized by Congress "to purchase the obligations of and to make loans to any business enterprise." It

provides a lending hand where the financial assistance applied for is not otherwise available on reasonable terms. The law requires that all obligations purchased and all loans made must be of such sound value or so secured as to reasonably assure retirement or payment.

It should be noted that the Small Business Administration is the successor to the Reconstruction Finance Corporation. And at the time it took over the RFC operations, the SBA gave preference to loans which fostered "military, defense, or essential civilian requirements." However, its present policy is to put on an equal footing all businesses applying for Federal aid—whether or not they are engaged in retail, wholesale, or manufacturing activities.

The SBA may make loans directly to business enterprises or in cooperation with banks or other lending institutions. When you are seeking a loan, you should always get in touch with a bank first, ordinarily the one with which you do business. If it cannot or will not make the loan, and if no alternative private source is willing to make the loan on satisfactory terms, you may then apply to the SBA office serving your territory. It is important to note that as a matter of policy, the SBA emphasizes "participation" loans in which the agency assumes a part of a loan made by a private lending institution. However, direct advances are made. For example, typical of the small businesses recently getting direct advances from the SBA was a California welding company. This concern got $18,000 from the agency for working capital and the purchase of welding machines.

If you are interested in SBA aid, get in touch with the nearest SBA office. It will advise what it can do under the law.

Federal reserve banks as a source of loans

The 12 regional Federal reserve banks are authorized to lend directly to business enterprises when they cannot get money from the usual sources on reasonable terms. These loans are at present limited to 5 years or less and are for working capital purposes only. The loans are available only to *established* businesses. New concerns cannot be accommodated.

The regional Federal reserve banks also enter into commitments with commercial banks and other financial institutions to participate in their business loans. If your local bank cannot make you a loan on its own, it may be able to do so in cooperation with one of the regional Federal reserve banks.

The Federal Housing Administration as a source of loans

There is special interest to the small businessman in several functions and activities of the Federal Housing Administration. Hundreds of small businesses throughout the country have found these FHA financing aids very valuable.

It is important to keep in mind that FHA does not *lend* any money. It does assist and stimulate lending of money by private institutions through the insurance of such lending agencies against loss.

As applied solely to business needs, FHA guarantees the loans this way:

Loans for modernization and repair of commercial properties. The maximum amount that can be borrowed from a lending institution is $2,500, repayable in equal monthly installments over a period not to exceed 3 years and 32 days. The loan may be used for almost any sort of structural alteration or repair work, such as repairs to the roof, the foundation, or the floor, the enlargement or reduction of the size of the structure, etc. It may also be used to install new fronts and show windows or a new heating and air-conditioning system. No proceeds of the loan can be used for the purchase or installation of machinery, equipment, or store fixtures. However, a loan can be made to strengthen foundations, walls, and floors of a structure in order to accommodate heavy machinery. The maximum amount the lending institution can charge for the loan may not exceed a discount of $5 per $100, payable in 36 equal monthly installments.

Loans for erection of new commercial structures, exclusive of machinery and equipment, include buildings, such as gasoline stations, wayside stands, service buildings, and the like. The maximum size of such loan is $3,000 and the maximum term is 3 years and 32 days.

Loans under this program, like all other FHA loans, are made exclusively by private lending institutions. For information on these loans, see your local bank, building and loan company, industrial bank, or any other lending institution authorized by FHA to make such loans. Or write to the Federal Housing Administration in Washington, D. C.

The "GI" bill as a source of loans

What are popularly referred to as "GI" loans are actually loans made by private lenders, as well as by the Small Business Administration. They are insured by the Veterans Administration. The loans may be made by any of the usual lending agencies and the loan procedure is essentially the same. One important feature is the fact that the rate of interest is restricted to a maximum of 4½ per cent on real-estate loans and 5.7 per cent on insured non-real-estate loans. Another is the fact that the VA guaranty may result in banks or other lenders making some loans which would have been refused without the guaranty.

The VA guaranty is available to any veteran who had 90 days' service or more between Sept. 16, 1940, and July 25, 1947, or after June 27, 1947, and was discharged under conditions other than dishonorable. If you had less

than 90 days' service but were discharged as a result of injury or disability incurred in the line of duty, you will also be eligible.

Sixty per cent of a loan for the purchase or construction of a home may be guaranteed up to a maximum of $7,500. Real-estate loans for business or farm purposes may be guaranteed for 50 per cent, up to $4,000. "GI" home or business real-estate loans may be made for periods up to 30 years.

"GI" loans can also be made for purchasing property other than real estate, such as machinery, tools, and equipment, and for working capital required in the operation of a business or farm. The guaranteed portion of a non-real-estate loan may be 50 per cent of the amount of the loan, with a maximum of $2,000, for each veteran participating in the loan. A non-real-estate loan can be made for a period up to 10 years.

Important: In certain areas of the country where private capital is not available for "GI" loans, the VA may make direct loans to eligible veterans. Check with your local VA office to see if you qualify for a direct loan.

You will probably find that the lender is more interested in your basic credit rating, assets, business experience, and know-how than he is in the guaranty. But you may find the guaranty helpful in your case. It is well worth investigating.

Community industrial development groups as a source of loans

Another source of small-business credit and capital is the community industrial development or financing group. If there is no such group in your area, you might want to play a part in starting one.

Some of these groups are technically private, while others are public; they are mentioned together for convenience. In Albert Lea, Minn., for example, the local committee for economic development led in setting up a private group called Jobs, Inc. It was capitalized at $100,000 for the purpose of providing fixed and operating capital for new and old local industries.

In Louisville, Ky., the community has for years successfully run an industrial financing corporation. Baltimore has a similar group called the Baltimore Industrial Corporation.

There are a number of other examples of local industrial development groups. Some of them provide not only long-term and other capital but also technical and managerial counsel. Many believe that they offer real promise for assisting and strengthening small businesses.

7. HOW TO PLAN THE BEST INSURANCE PROGRAM FOR YOUR BUSINESS

Insurance is a personal and economic necessity in any business. Without its protection you may lose part or all of your investment in your business. Or you may become liable for lawsuits that may be brought against you and your business.

Getting the most economical insurance rates—these may not be the cheapest

How can you be sure you are carrying all necessary coverages, under properly written policies, at the lowest possible cost for sound insurance?

Most important is to move only upon the advice of a competent, reliable insurance agent. This is one problem on which you need expert advice.

If you place insurance directly with nonagency mutual or reciprocal companies, have a disinterested adviser check the correctness of contract conditions, rates, premiums, etc.

Ask your broker if all insurance companies used are legally able to do business in the state where the property or risk insured is located, and if they are so sound financially that there can be no doubt about their ability to pay any and all losses in full. You can check with your state insurance commissioner or your lawyer. You can check the insurance company's rating in rating books such as those published by Best and Company. Find particularly what the reputation of the company is in regard to settling losses fairly and promptly.

Be sure you divulge all material facts when the policy is negotiated. Then the policy will not be voided on the grounds of fraud or misrepresentation.

Be sure you get a binder or acknowledgment as evidence that you are insured between your order and delivery of the policy. And do the same with renewal policies.

Examine your policies when they are issued. Do it from time to time thereafter to see if insurance company and form of policy are approved by your state's insurance department. You ought also to get your broker to do this:

Check the terms, conditions, and rates of new and renewal policies, especially those which are directly negotiated mutual policies

Read the policy *exclusions* for things *not* covered or *not* permitted under each kind of policy. Your broker or agent can readily point these out to you

Review the forbidden actions, etc., from time to time. Changes in your business since the policies were issued may have technically voided some policies

Get a permit for you if one is necessary. He can obtain the necessary indorsement from the insurance company

Avoid paying larger premiums than necessary because of overlapping coverage of policies providing similar protection

Take advantage of changes in rules, rates, and classifications to reduce your premium cost or obtain broader coverage at the same cost

Keep adequate records of all data necessary to comply with the requirements of your policies and a record of the policies themselves. Do that this way:

Include a tickler or some follow-up system that will notify you well in advance of each policy expiration. This should include a second reminder on the expiration date in case the policy or a binder acknowledgment has not yet been received

Include a record of each policy, showing the name of the company, number, coverage, rate, premium, expiration, and changes, if any, during the policy term

Have books of account showing the original cost of buildings, machinery, equipment, furniture, and fixtures, and the date and cost of additions or disposals

Have a record to help in proving a merchandise loss, showing insurable value of inventories, monthly if possible, so that the amount of insurance may be adjusted if necessary

Remember that many kinds of insurance specifically require that adequate records and books of account be maintained to prove and collect for a loss under the policy

Steps to take when you have a loss

Whenever you have a loss that you believe to be covered by your insurance, be sure to notify your broker or the insurance company immediately. In most cases your broker will promptly report for you.

If the loss is under a fire or similar policy, do what you can to prevent further loss or damage. If possible, separate the damaged from the undamaged property. Make temporary repairs or replacement, if permitted or called for by the policy, to prevent further loss

If the loss is a personal-injury or property-damage claim (except under the workmen's compensation law), provide first aid if necessary and permitted by the policy. Forward all such information, including the summons, if any, as promptly as possible to the insurance company

If the loss is by burglary, holdup, or theft, also notify the police authorities.

If a loss occurs through an employee's dishonesty and a bond is carried, notify the surety company as soon as the loss is discovered

File your proof of loss within the time specified in your policy. Get professional help in filing adequate claims. Keep a tickler memo of the date your claim is due, so that an extension may be obtained if it is not possible or advisable to file the proof by that date.

What are the usual policies a small businessman needs? Here is description taken, in part, from an excellent booklet issued by the New York State Department of Commerce.

How to buy fire insurance

All-important is *fire, lightning, and windstorm insurance* to protect against financial loss because of damage or destruction of merchandise on hand, or buildings, as a result of fire, lightning, or windstorm. Damage caused by smoke or water accompanying a fire on your own or adjoining property is also covered by this insurance.

The charge per $100 of valuation depends on the construction of the building, the kind of business being operated, the nature of adjacent buildings and their occupancy, local fire protection, and other elements of risk.

You want to be sure that insurance carried on building, machinery, equipment, fixtures, and stock is adequate. You will have to watch especially rising replacement values if you hope to collect in full in case of total loss. Remember that, if a coinsurance clause is attached to your policies, you can collect partial losses in full only if the agreed-upon ratio of amount of insurance to value is correct. *Here is how to keep costs down:*

Adjust the amount of insurance regularly in order to be fully insured when inventory values are up and to avoid paying unnecessary premiums when they are down. You may be able to obtain a "reporting" form of policy under which the amount is adjusted automatically at prorata cost

You will gain nothing by overinsurance. The amount of protection should be based on the actual replacement value of the property at the time of the fire

Review your coverage from time to time to ascertain whether you are paying excessive premiums on property that has decreased in value

Check your stock against insurance coverage to see whether policies cannot be adjusted downward, unless current higher prices make up the difference. Spread the coverage properly among actual values of stock, building, and fixtures

Give extra attention to fire prevention. You can get suggestions from insurance companies through their inspectors or from the National Board of Fire Underwriters. Get your broker to arrange for it—and for the cost cutting that follows

Reduce fire hazards by keeping all trash cleaned up, by having all wiring properly insulated, by installing fire shelters and extinguishers, and by using approved containers for inflammable liquids. Be sure "no smoking" rules in prohibited areas are lived up to

Check the possibility of premium savings through improvements in buildings, equipment, and services, as—

- Fireproofing of your buildings
- Installation and improvement of automatic sprinklers or other fire-fighting apparatus, fire escapes, etc.
- Improvement in your water supply
- Maintenance of watchmen and private fire brigades
- Arrangement for adequate inspection of premises
- Provision for first-aid room or emergency hospital for industrial accidents
- Installation of proper guards on dangerous devices or operations

See if your policies are eligible for cheap supplemental endorsement covering losses from tornado, explosion, riot, or aircraft damage.

What other forms of business insurance do you need?

Take the time to consider other losses you might have. Here is a check list of important types of policies:

Business-earnings insurance. This protects against incidental losses directly resulting from a fire. It provides: payments to meet expenses which continue while the place of business is being repaired; compensation to cover the profits lost because of suspended business operations as a result of a fire. Types available are—

Business-interruption insurance, which pays a business for loss of earnings resulting from a shutdown of the business caused by fire or other named peril

Extra-expense insurance, which pays a business for the extra expenses necessary to prevent a cessation of the activities of a business following damage by fire or other named peril. This kind of insurance is commonly needed by businesses such as newspapers, laundries, and dairies, whose customers depend upon them for uninterrupted service

Rent or rental-value insurance, which indemnifies the owner of real estate for the loss of rental income or of the rental value of his property should it be destroyed by fire or other named peril

Workmen's-compensation and employer's-liability insurance. This is a required coverage in many states for specified employers. It covers the liability of the employer imposed by law, regardless of fault, for injuries or occupational diseases sustained by his employees. Employers' liability coverage is afforded in the compensation policy to cover the liability of the employer to the employee where the compensation law is not applicable.

Casualty insurance. This protects the insured against loss from an unfortu-

nate occurrence which happens without design or without being foreseen. It includes—

Contractual liability. Covers claims resulting from the liability of others which the assured has assumed under the terms of a lease, purchase, or other contract

Products' liability. Covers the liability of the assured for damages resulting from the consumption or use of any product manufactured, sold, or distributed by the assured

Druggists' liability. Covers the liability of the assured for the preparation, compounding, dispensing, sale, or misdelivery of drugs, medicines, or merchandise customarily handled by drugstores. (A similar form is available to cover optometrists against claims resulting from improper fitting of glasses)

Elevator liability. Covers the liability of the assured resulting from the maintenance or use of elevators, hoists, escalators, etc.

Comprehensive liability policy. Provides all needed protection in a single contract. The assured pays a premium based on his actual exposures to loss hazards. Automobile bodily injury and property damage insurance may be included in the comprehensive policy

Burglary and theft insurance. This covers the assured for loss of or damage to property resulting from burglary, theft, larceny, robbery, forgery, fraud, vandalism, malicious mischief, confiscation, or wrongful conversion, and against loss or damage to money, securities, and other valuable papers resulting from any cause. Various forms of coverage are provided under this type of insurance, such as:

Dishonesty, disappearance, and destruction policy
Broad-form money and securities policy
Safe burglary and robbery policy
Storekeepers' burglary and robbery policy
Merchandise burglary policy

Glass insurance. This covers the assured for loss or damage to glass, including the frames or sashes in which the glass is set.

Water-damage insurance. This covers the assured for loss or damage caused by water or other fluid to any property resulting from the breakage or leakage of sprinklers, or resulting from water entering through leaks or openings in the buildings, and includes coverage against accidental injury to sprinklers, pumps, and other fire apparatus.

Boiler and machinery insurance. This covers the assured for loss or damage to any property of the assured resulting from the explosion of a boiler, heater, or other fire-pressure vessel.

Credit insurance. This covers the loss to the assured resulting from the extension of credit or from the nonpayment of debts owed to him.

Fidelity bond. This guarantees an employer against loss caused by dishonesty of employees. There are different forms of fidelity bond designed to cover various types and sizes of business establishments. Your agent or broker will gladly recommend the particular form best suited to your needs.

License, franchise, and permit bonds. You may be required by Federal, state, or local government to file this class of bond. License bonds are sometimes required to guarantee compliance with regulations, laws, or ordinances. Franchise bonds are needed, in some instances, to grant the right to conduct a business for the common good under certain specified conditions and guarantee that service will be maintained. Permit bonds usually grant privileges to perform certain acts incidental to the conduct of certain types of business.

Bid and contract bonds. If you are going into the construction or manufacturing business or into certain types of mercantile business, you may need bid and contract bonds. These bonds are usually required from those who supply foodstuffs, fuel, building material, etc., to the Federal, state, and local governments, corporations and large industrial organizations, etc.

Comprehensive dishonesty, disappearance, and destruction policy—It covers loss through the dishonesty of employees. In addition—

It will protect you against loss of money and securities caused by destruction, disappearance, or wrongful abstraction and also against loss of other property due to safe burglary and robbery from your business premises

It will protect you against loss of money and securities caused by destruction, disappearance, or wrongful abstraction while being conveyed outside of your business premises by you, your partners, officers, or employees, and also against loss of other property due to holdup or robbery while being so transported

It will protect you against loss of securities caused by destruction, disappearance, or wrongful abstraction while within a leased safe-deposit box on the premises of a depository (bank, safe deposit company, etc.) or from within the premises of the depository while temporarily outside the safe-deposit box

It will protect you against loss through forgery of your checks or other negotiable paper issued or alleged to have been issued by you

Bodily-injury and property-damage liability insurance. This covers liability of the assured for bodily injuries and property damage in the operation of vehicles owned by him or vehicles of others occasionally operated by him.

Nonownership liability insurance. This covers the liability of the assured for any loss arising out of the use in his business of automobiles not owned or hired by him.

Hired-car liability insurance. This covers the liability of the assured for loss arising out of the use of automobiles hired by him.

Medical-payments insurance. This provides for payment regardless of legal liability of medical, surgical, hospital, and nursing expenses necessitated by accidental injuries to any occupant of the insured automobile, including the assured himself.

Collision insurance. This covers the loss through damage or destruction of the assured's car by collision or upset.

Garage liability insurance. This covers the liability of the assured for loss arising out of his operations as an automobile dealer, repair shop, storage

garage, or service station. It covers public liability not only for the operation of automobiles but also for all work necessary in the conduct of the business.

Owners', landlords', and tenants' liability. Covers public liability on mercantile buildings, apartment houses, stores, vacant lots, etc., and provides protection to the assured resulting from the ownership, maintenance, or use of the insured premises.

Manufacturers' and contractors' public liability. Covers the liability of the assured for damages on account of accidents to persons not engaged in the employ of the assured due to any business operations of the assured.

Owners' or contractors' protective public liability. Covers claims against the assured caused by operations performed for the assured by independent contractors or subcontractors or their employees.

Consider life insurance for your business

Business life insurance is insurance used to meet the hazards of loss by a business from death of someone associated with it. This insurance involves nothing different from the basic life policies. But it does require a special application to meet the problems peculiar to the business.

It usually involves more than the simple act of taking out a personal policy payable to the business. The many legal, financial, tax, and technical complications require careful study of the case by experts. Each business life-insurance policy must be custom tailored. Specific purposes for which business life insurance is written are—

Key-man protection to reimburse for loss or provide replacement in the event of the death of a key employee. Almost every business has one or more men upon whom it depends heavily for its major success. Frequently it is the proprietor or manager. It might be: the financial man, upon whose shoulders rest the firm's credit, either for providing new financing or for temporary credit needs; the sales manager or, in the case of a retail shop, the leading salesman; a chemist, engineer, or scientist whose technical efforts produce the firm's lifeblood of ideas. Any one of these people could be of such importance to the business that his death would cripple it, or at least cause a setback until a replacement was secured. Key-man insurance provides insurance benefits at the death of this vital employee, so that the firm has resources provided with which to employ the successor in the competitive market.

Partnership insurance, to retire a partner's interest at death. A partnership automatically dissolves at or shortly after the death of any one of its partners. There is an especially vital need for life insurance protection to safeguard the business against forced liquidation. The adequate partnership insurance program accomplishes several objectives: it enables the surviving partners to reorganize at once and continue in business; it liquidates

the interest of the deceased partner without loss; it enables the beneficiaries of the deceased partner to secure full, fair value for his interest in the firm, at once and with a minimum of trouble; and it lends support to the credit standing of the firm.

Corporation insurance, to retire a shareholder's interest at death. A corporation is not so directly and immediately affected by the death of a shareholder as is a partnership by the death of a partner. But unfortunate consequences are a distinct hazard. With the transfer of the shares of the deceased stockholder, new stockholders, new to management and possibly an unknown element, may come into the picture. Sometimes, too, the stockholder's death may deal a severe blow to the firm's credit. An adequate corporation insurance program on the life of the shareholder, to provide retirement of his interest at death, meets both these situations. It gives the deceased shareholder's heirs full value of his interest at once. It reduces the shock of changes in ownership. This is of special concern to the small corporation where the shareholders are few. Their interests keep them close to the management of the firm, shareholders and management possibly being one and the same.

Proprietorship insurance, to provide for maintenance of a business upon the death of a sole proprietor. This effects continuity for the business. It provides the proprietor's dependents or heirs with sound valuation of the business at his death. It is the nearest to ordinary personal insurance of all types of business insurance. In the sole proprietorships, there are special considerations that should be recognized when writing the business policy:

- Adequate provisions must be written into the policies to meet the conditions of a will or trust agreement concerning sale or liquidation of the business
- Selection of the beneficiary must be made according to the particular situation; payment of premiums should be established definitely according to the best interests of the plan
- One plan may call for sale of the business to stated employees, with the purchase money provided by the insurance; another may provide that the business be run by the executor of the heirs; in still another, a trust company may be named as beneficiary and management control may be established. The specific plan is important, however. Many a small business flounders upon the death of the sole owner merely because he did not provide the business insurance with which to maintain it
- Insurance to aid the firm's credit status, covering the owner or key man during the period of a loan or the duration of a mortgage on property held

Insurance for emergencies. Most business life-insurance plans utilize life insurance which has cash values. These cash values, growing over the years, provide the firm with a valuable reserve for emergencies, in the event of any sharp dislocation in business conditions. Where necessary, the policy cash values can be used as the basis for loans.

If you contemplate the business life-insurance plan, call for advice Consult three experts to make certain that every angle of the firm's interests is being safeguarded—your CPA, attorney, and life-insurance agent. The last-named gives the technical advice concerning the arrangement of policies. The first two provide the essential information on which the plan is based and double-check it when it is completed. Remember this:

Tax factors, both income and estate, are involved in almost all business life-insurance arrangements. A plan should not be set up which will unnecessarily involve additional taxes. On the other hand, too much weight should not be given to the tax angles. They often change, and the plan set up today on the basis of a certain tax advantage may prove to be disadvantageous next year, if a new tax law is enacted. This, too, is a matter that should be left in the hands of the experts

Once established, the business life-insurance plan should receive, carefully and periodically, a checkup by experts. Financial conditions change, tax laws vary in effect. Valuations of the interests of the owners are never constant. A host of changing conditions can affect the plan and it is important that the details of the plan be kept up to date at all times

Revaluations should be written in, whenever necessary, on partnership and corporation policies

Every new tax law suggests need for a special checkup to make certain the tax angles are still adequately covered

At least once each year, the plan should go through this careful screening by the life-insurance agent

Favorable tax laws make pension or profit-sharing plans advantageous

Favorable income-tax laws have made it highly advantageous for small business to provide directly for its own people through the creation of pension or profit-sharing plans. Most of these involve insurance.

The law does not hamper the ingenuity of those who want to draw these plans. However, it gives its preferential treatment *only* to employers who do not discriminate in favor of higher-priced employees or the officer or stockholder group. An employer's plan *must* benefit a large percentage of the employees generally if he is to gain any advantage from the law.

There are two very broad schemes used today—the pension plan and the profit-sharing plan. The first is usually adopted where the earning record of the business shows a reasonable amount of stability. It envisages a more or less regular contribution by an employer to the pension trust or fund, regardless of the extent of the profits.

A pension plan *must* be "actuarially sound." That is, the contributions must be substantial enough to fulfill its purposes—for example, payment of a

fixed monthly sum when a person reaches a predetermined retirement age and retires, or when he can no longer work because of infirmity. These pension payments then continue until his death.

A profit-sharing plan, on the other hand, is more responsive to the changes in the employer's business. The employer is not obligated to pay a fixed annual amount into the fund. He contributes in accordance with a formula (set forth in the plan) which is keyed to his profits. Thus, in bad years he may contribute nothing, while in good years the contributions may be substantial. The profit-sharing fund is not "actuarially sound," since the employee is not promised a fixed or predetermined amount of benefits.

Profit-sharing plans create an incentive in the employee to help increase the employer's profits.

Pension plans give the employee peace of mind through fixed and prearranged future benefits. Many additional advantages flow, both to employer and employee alike, from the operation of either or both of these types of plans.

The type of plan to inaugurate in each case depends on the probable future of the business. A small businessman should consider the problems likely to arise in a future period, such as the financial aspect of operations, the rate of labor turnover, the proportions of young and aged workers employed, the rate of mortality, and the tax burden.

The plans usually provide for a trustee. They usually provide that the arrangements be tied in with insurance contracts.

Why should a small business take the initiative to create its own pension or profit-sharing plan? What practical advantages have businessmen already experienced from the adoption of their own private systems of benefits? Here is the record:

The cost is relatively insignificant in years when tax rates take so much of income. The expense of building the plan is a good tax deduction High tax rates thus stimulate the creation of retirement systems

Experience establishes that when pay rates are fixed by community standards, workers naturally gravitate toward employers who have created a retirement system. That means so much additional compensation to employees

The creation of an effective plan often diminishes demands for wage increases. At least, it often blocks them. The argument that the benefits under a plan are more advantageous to the workers than an immediate pay increase is forceful and logical

For the first time, employers have a decent way to ask workers whose efficiency is diminished by the infirmities of age to give way to the more aggressive. With retirement pay assured, the difficulty of discussing retirement with old people is avoided

Properly presented to employees, private social-security plans become potent factors in building loyalty and enthusiasm

Most of the established plans have been adopted by corporations. But small business partnerships and sole proprietorships can also derive substantial benefits from some of these plans. The individual partners and proprietors cannot participate in the plan because they are *not employees.* In partnerships, they have the following advantage, superior to that given to a corporation: contributions are deductible in proportion to their interests; if they are in the higher tax brackets, these deductions will give them a much greater tax benefit than would be given to a corporation earning the same income

If the plan is drawn and operated to conform with the very reasonable requirements of the law, a goodly portion of employees' income earned today (when the tax rates are extremely high) will be taxed many years later. Then the tax rates, presumably, will be lower.

While these deferred-compensation plans cannot be used as a device for tax avoidance, they are not taboo merely because many of the stockholders, officers, or high-priced executives incidentally benefit as employees. Yet this windfall may be very substantial. Many of these persons have large incomes at present. They are hit exceedingly hard by our present-day progressive tax rates.

If some of their present income is deferred until a future date, to be then paid to them as a pension, it is unlikely that their income will then be a part of the higher tax brackets. Presumably, they will then be retired and will probably have a more moderate income than they had at the peak of their activity.

How do you organize your employee benefit plan? Before you start, check over with your CPA, lawyer, and insurance experts to find what kind of plan you want and—

What termination rights you want to retain
Whom the plan will benefit—what employees
What investments the plan can make
How you will avoid discrimination in your plan

When you know about these, here are some aids to your planning: find—

What employees should be covered. Classify them by length of service or amount of salary

Date of benefits to employees. Should you make it 65 or even less in high-pressure jobs—possibly accelerate the date if an employee desires to have it moved up, or provide that you can defer it for a long period if men elect to remain on their job?

Benefits. Determine how you will pay. What percentage at retirement age? How much per month; how much in a flat sum?

Other benefits. See if you want to have any part of the trust paid to employees as emergency loans, or as health and accident insurance, so that you can really use the funds in periods of distress

What happens at death, discharge, or disability before retirement. Usually the benefit should go to the employee or his estate

How you are going to pay the cost. Sometimes it is paid entirely by the employer and at other times by a contributing arrangement with employees; the latter plan may be desirable to impress your employees

Trustee. The handling of the funds by outside trustees permits assurance to your employees and the Treasury that you have a bona fide plan

Find how you want to make your contributions. There are a great many processes: annual contributions to provide a fixed annual sum at retirement for each employee; appropriations of profits for distribution to the accounts of employees on the basis of their annual compensation, or their compensation plus years of service. This type of payment plan may or may not produce a definite sum for individuals at retirement. They simply get everything in their account.

Your experts will discuss your proposal thoroughly with the Treasury. They need to be certain that: your own contribution to the plan will be deductible; the amount set aside for employees will not be taxed to them until they receive it.

After creating the plan, announce it to your employees. Do that by a simple announcement in plain English without any legal complications. Furnish them with copies of the agreement, and ask them to complete any blanks that may be necessary to secure their participation.

8. HOW TO BUY AN ESTABLISHED BUSINESS

One of the most customary methods of going into business is to buy a going concern. Advantages of this method include the following:

The business may be bought at a bargain. Someone who is desirous of getting out, for reasons such as health or advancing age, may be anxious to sell and willing to take a low price

The previous owner has brought together those assets which are necessary to conduct the business. The new owner can benefit from his knowledge and experience, and avoid making some of the mistakes which he might otherwise make

When buying a going business, the new owner acquires patrons. Thus, a certain volume of business can be accurately predicted. To that extent the risk is reduced

Stepping into a going business gives the new operator the benefit of a running start. He does not have that initial waiting period. The income can start more quickly. There will be less drain on the resources during the period when trade is being developed

Advantages and disadvantages of buying an established business

As with so many things, these benefits may be offset by disadvantages. Some of these are—

The previous business may have been a failure. Such a business would carry a handicap because it is difficult to overcome its reputation

There are some locations where a business venture is almost certain to fail. It may not always be wise to take advantage of the bargain offered by a predecessor. It may be that sufficient business could not be developed at that location, regardless of the owner's ability

While it is an advantage to step into a going concern and receive the benefit of someone else's skill and judgment, buying a going business may result in saddling the buyer with his predecessor's mistakes. The previous owner may have made poor choice of equipment or been unwise in his inventory purchases

Although the going business inherits certain customers, it also penalizes the new owner. Potential customers may have formed the habit of *not* trading with it. It may be some time before they have a chance to become acquainted with the new owner or even become aware of the

fact that the business has changed hands. This difficulty may be overcome by good management and advertising

But even though a going concern is bought, it can become a new venture—under new management and new policies—perhaps with a new front and new interior layout. The new venture, clearly so labeled, often attracts people who like to try new things and trade at new places.

The new business—bright and shining, with new fixtures, fresh stock, and new faces—has an advantage in attracting people who often say: "Let's go in and try this new place."

Steps you ought to take when you investigate another business

What are your steps in a purchase? Here is a useful list of things to do:

Make your plans to study at least three things: your opportunity for profit if you go ahead; the history of the business (its legal, financial, and other points); the tax aspects of your purchase.

How do you find your opportunities for profit? What first, are the risks in the purchase? That requires you to find: the long- and short-term chances for profits; your chances of getting a fair return on your investment. It means study of extra investment you might have made in rehabilitation, repairs, and improvements to get profits. Is the return on the total investment adequate?

You should audit the business thoroughly. Break this process up into four parts:

1. *Get a competent CPA who knows the business to give you a full record of its financial and operating history.* Make sure he finds out all about the following things for you:
   - Contractual commitments at higher-than-market prices
   - Unfulfilled contracts for sales at too low prices
   - Contracts and claims that affect future financial conditions of prospective customers
   - Whether or not some accounts or inventory have been pledged or assigned, without being so indicated
   - Receivables for goods shipped on memo or consignment or accounts for goods sold but not shipped
   - Status of contingent liabilities—if they are adequately disclosed in the financial statement
   - Whether the company has indorsed or otherwise guaranteed any obligations of others. This includes negotiable instruments sold or discounted
   - If individual firm members or partners have become contingently liable by indorsements and guaranties on obligations of others

Damage claims, lawsuits, disputed assessments, or possible tax liabilities

If the business is liable on a mortgage bond where the mortgaged property has been sold to others subject to the mortgage. Attempt to estimate the probability of a deficiency judgment

Amount of cumulative dividends in arrears

2. *Get a lawyer to check—*

The chain of legal title

Leases, and machinery rented or leased

Patent arrangements and registration of patents; trade-marks, formulas, and copyrights, franchises, and transferability

Encumbrances on the property—mortgages, liens, chattel mortgages against machinery and fixtures, judgments against the seller, condemnation proceedings under way, taxes in arrears

Zoning restrictions, (for example, those which may come into effect for the first time with change of owner, whether area may be restricted to residences or as to type of building material, sewage-disposal arrangements)

Ask, too, for a check on—

Restrictions on ownership

Public use of property for street, alley, highway, etc.

Renting regulations

Smoke-nuisance legislation

Other building regulations—sprinklers, fire escapes, roofs, and sidewalks

Whether you have the right of way over someone else's land to get to your property

Rights to oil, gas, minerals, and timber; quarrying rights

Legal duties and obligations you will become subject to; for example, filing frequent and numerous reports to government agencies

Labor restrictions, health laws—workmen's compensation, fire, liability, and automobile insurance; workmen's-compensation law; local health and inspection laws

3. *Get a full record of the labor relations of the business.* Make sure you understand—

Government agencies to which the business is subject

Relationship that exists as to compliance or violations—

Fair Labor Standards Act, National Labor Relations Act, state labor laws, etc.

Union contracts in force, previous labor disputes, present relations with the union

Wages, hours, and working conditions

Age and sex of employees

Possible turnover in postwar period

4. *Make sure you fully investigate the business among its banks, customers, and creditors and in its community.* Determine the real

reasons the present owner has for wanting to sell the business; try to find out from his creditors, competitors, bank, business agent, employees, trade associations, etc. Take nothing for granted—double-check every possible contingency

How to buy a business tax-wisely

Consider your own tax problem—by what method shall you buy the business? Shall it be one to give you the seller's tax basis of assets? Or shall it be one giving you the fair market value of what you buy as your tax basis?

If you use cash to buy, that determines the value used later in depreciating or in selling. If you use stock or securities, you might get considerable tax advantages in some cases to the seller or yourself. Study, too, whether you should buy stock of the company or its assets. They may make a great difference in your tax position. This section is an effort to aid you in making these decisions.

Sometimes a business has been made successful because of the personal efforts of one or two principals in that company. It may be advisable to employ these principals. Your payment of their compensation gives you a full tax deduction. Perhaps agreement to pay them the highest possible reasonable compensation for a long period will get you a good reduction in purchase price.

Consider a long-term lease instead of a purchase of the assets of the other business. You will still get a tax depreciation deduction, if you also agree: to replace losses caused by depreciation or obsolescence; or return the property in as good condition as when delivered.

Control your interest deductions carefully in your purchase. It may be to your advantage to decrease the annual installments of selling prices and increase the yearly interest. The latter is a tax deduction when paid over a period of years.

If you buy real estate, make sure that you are entitled to a deduction for the property tax that you adjust with the seller at the closing. Turn to page 140 to see when and how you and the seller may be able to share the deduction for the same tax.

If you buy a building or other property with the intention of demolishing, neither the cost nor the expenses of demolition are deductible. They are added to your cost of a new building. But if you do not have this intention at the time of purchase, but later decide to demolish, you get the loss deduction. This means you want a good record to show your intentions.

If you are buying a business and you have an agreement that the sellers or others will not compete, be sure that you get a value on this part of the

sale. And set a definite period of time for the restraint. This kind of payment to an individual can be deducted over the period of the restraint.

Arrange your transaction to avoid paying a tax on part of the purchase price. Here is the sort of planning you can do:

Assume you agree to buy corporate stock. Assume, too, that your price of the stock reflects the higher market values (over corporate costs) of inventories, real estate, etc. When these assets are sold both the corporation and you (when dividends are distributed) will pay a tax on a book profit. That contains a return on your capital invested. Make sure your buying plan does not include that penalty. Seek a purchase of assets, or get an adjustment for the penalty you are assuming. Of course your deal to buy stock may give you a real advantage. You may pay $100 for stock of a company whose assets cost it $1,000 and are worth only $100. Then you may get deductions based on the $1,000.

Take another case—you want to purchase the stock of a company that has an accumulated surplus. When any corporate distributions occur they will be taxed as dividends to you. This is so, even though in reality they represent in whole or in part a return of your capital. Assume your stock will cost $100. The company has assets costing $50 ($40 of surplus and $10 of capital) which are now worth $100. If it pays dividends you will have ordinary dividend income up to $40. You really should get no income until you have recovered your $100. You ought to avoid that penalty.

But the seller may insist on selling the stock of his corporation. You may want to buy the assets rather than the stock. You may be helped by having him liquidate his corporation. Then he sells the assets to you. If that is not possible, see if you can get a contract from the seller to indemnify you for your tax losses.

When you buy a business you have to decide if you want the seller's tax basis of its assets. Or do you want the fair market value of what you buy as your tax basis? That choice comes when you make your plans to acquire the property. If you acquire property or stock in a tax-free transfer, you usually take the other fellow's cost of property or stock. If you buy, that then is tax basis on your later sale of the property. You may get more or less than his cost basis.

Get your CPA to explain these tax principles involving your cost basis:

If you use cash or property to buy property, that determines the value used later in getting tax deductions, depreciating assets, or selling

You may buy stock of a company, or buy its property by stock or securities following it by a tax-free reorganization plan. Then you sometimes get considerable tax advantages by exchanging your stock for the seller's. In another case, you may get an advantage by purchase of property

Whether you buy stock of a company or its assets may make a great difference in your tax posiiton. The method you decide on may involve material tax cost or tax savings.

You have a bargaining point in preserving the seller's tax advantages

There is another very important point to remember: many advantages accruing to your vendor may be lost when you buy the assets of the company and it loses its identity. Check this problem with your tax adviser.

You may even face this same problem of preserving the seller's tax advantages when you continue the old business identity. Here you have to be wary of the following two rules:

1. Tax-evasion or -avoidance rule. This gives the Treasury the power to take from you any deduction, credit, or allowance which you got on buying another corporation if it can show that you bought the company for the principal purpose of getting the benefit of the particular deduction, credit, or allowance. For example, that means if you buy a loss corporation just to get its loss deduction, you could be hit with this rule and lose the deduction. To help prove its case, the Treasury can use this added rule: If what you pay for the corporation is substantially disproportionate to (*a*) the total of the tax basis of the corporation's property and to (*b*) the tax benefits which could only have been gotten through the purchase—then this fact is prima-facie evidence that the principal purpose of your purchase was to avoid or evade income taxes. If the Treasury can show this, then you have to show facts to rebut this presumption or lose the tax benefit received on the purchase of the corporation. For example, you might show a specific business purpose for the acquisition like enlarging your productive facilities and show that the price was a fair one, despite the tax benefits received. *Note:* You might clear this hazard but still be covered by the next rule.
2. Change-of-ownership rule. Here you are safe as long as you continue the corporation's business or trade and do not run afoul of the tax-avoidance rule explained above. The net operating loss is disallowed where the corporation's trade or business is changed and 50 per cent or more of the corporation's stock changes hands during a period of two years as a result of purchases.

How does the 50 per cent rule work? The law says that one or more of the 10 largest unrelated stockholders must own, at the end of the tax year, a percentage of the fair market value of the outstanding stock which is at least 50 percentage points more than such person or persons owned at either the beginning of the tax year or the prior tax year. This does not apply unless the 10 largest stockholders own at least 50 per cent of the fair market value of the outstanding stock. And then it is only applicable if one or more

of such 10 persons has increased the percentage of the fair market value of the outstanding stock he or they own by 50 percentage points or more during the specified period. An increase of 50 percentage points does not mean the same as a 50 per cent increase. For example, a stockholder who owns 4 per cent of the fair market value of the outstanding stock and who increases his ownership to 6 per cent as had a 50 per cent increase in ownership but only a 2-percentage-point increase.

You cannot avoid the limitation through the purchase of an interest in a corporation, partnership, or trust owning stock in the corporation with the net-operating-loss carry-over. But an increase in percentage of stock owned resulting from a purchase by some other person, a tax-free reorganization, a gift, or a devise is not counted. The law says that persons so related to each other that the stock of one is attributed to the other shall be considered as only one person solely for the purpose of selecting the 10 persons (more or less) who own the greatest percentage of the fair market value of the stock.

How to break down the purchase price to your best tax advantage

You may be buying an entire business. Then you generally get your greatest tax advantage by insisting that the seller allocate your purchasing price to assets that give you your greatest tax deductions and the greatest capital gain on disposal. To do that, you should seek to place the following values:

Value merchandise inventory, stock in trade, at a high price. A high cost will reduce profit since your costs would be fully deductible

Value supplies and similar items not used in the manufacture of the product at a high price. These supplies will be used as expense items in the ordinary course of the business—your cost is fully deductible

Value accounts receivable at a high price. Loss from bad debts would be business bad debts and fully deductible

Value machinery and equipment of short life at a high price. The short span of depreciation gives you little time to recover the cost. Loss on sale or abandonment is fully deductible

Value buildings, building improvements; machinery, equipment of long life at a low price. You have a long period of depreciation to recover cost. The loss on sale or abandonment will be fully deductible

Value land at a low price. You get no depreciation deduction to recover cost. Gain on sale would be a capital gain

Value patents, copyrights, franchises, etc., amortizable intangibles, at a high price, if the remaining life is short. You recover cost rapidly by getting reduction of income over the short period left for amortization. But value these at low figures if you propose to sell the asset. Then you may get the 25 per cent rate on a sale

Value stocks, bonds, and securities at a low price. You get no annual depreciation. Gain would be taxed at capital gain rates

Value goodwill at a low price. You get no annual deduction for depreciation. The cost would be recovered only through eventual sale of the business. But place some value on goodwill in order to have a cost basis. Any profits in a sale would be capital gains

Value any covenant of the seller not to compete with you at a high price. The payment is fully deductible over the period of the covenant. This covenant must be carefully defined (sum and period covered) in the contract or else the sum for it may be held to be payment for goodwill

Check list when you close title

Pretty generally, you must have counsel approve what you do and how you get approval of a seller's stockholders, partners, creditors, etc. Essentials to study with him or your CPA are—

What is the closing date of the payment and what do you get on that day?

If you are buying personal property (merchandise, stock in trade, fixtures), check with counsel on how to comply with the state bulk-sales act. How does the seller (or do you) satisfy any chattel mortgages, liens, conditional bills of sale, etc.?

If you are buying real property, consider whether you want a full covenant and warranty deed; consider assuming the mortgage. You will be responsible for the payment of interest and amortization. Provide for risk of loss between the period of the contract and closing in the event of a fire or other casualty. Make sure you get adjustment for all payments of land taxes, water rents, payments to mortgagee, utility services (electricity, gas, telephone, etc.), insurance payments on policies of fire, casualty, plate glass, etc.

Note this well about your real-estate taxes when you are buying property: You can buy real estate and still get a deduction for taxes paid by your seller if you and the seller are both on the cash basis or if you or the seller is on the accrual basis and have elected prior to the date of sale to prorate the real-estate taxes over the period covered by the tax. Real-property taxes for property sold during the year are divided between the seller and buyer. Each gets a deduction for a portion of the current property tax this way: the seller, for that portion of the tax up to the day before sale; the buyer, from the day of the sale. What about the seller's back taxes? These are the seller's deduction. The buyer gets no deduction for paying the seller's back taxes. It becomes part of the buyer's purchase price if he agrees to pay the back taxes

How is the obligation to employees to be fully met? If there is a pension plan or profit-sharing trust, ask counsel what happens to it in a sale

Check your union contracts to find if there is severance pay

How are the accounts receivable to be handled? The seller might do the following: assign them for collection; sell them outright, the buyer doing the collecting; sell them as part of the business; sell them to a similar business. Here you may get something for the possibility of the continuance of business from the customer

How do you adjust all your uncompleted contracts and commitments—deals with unions, sales, service agencies, contractors of every kind, insurance companies, creditors, etc.?

If there are inventions, patents, or copyrights, or if the seller has been operating under licenses, do you want a release from your obligations under the license agreements?

What government agencies must be notified (for example, Bureau of Internal Revenue, Social Security Board, state unemployment-insurance agencies, etc.)?

How do you get all legal documents (titles, leases, mortgages, etc.) to show the change?

How are insurance policies to be converted to cover the new ownership?

How should customers be advised? If possible, explain the reason for the change in terms of better service, products, etc.

How do you tell employees? They will find out about it in due course, and it will help personnel relationships for you to tell them

How do you tell suppliers to get full advantages from a credit point of view? Be the first to give the information, and present it in the most favorable light. First to be informed from this standpoint should be the seller's bank

Every possible advantage should be secured from the change. Perhaps you should think of advertising it as a source of community goodwill and benefit to the general public.

9. SHOULD YOUR BUSINESS BE A PROPRIETORSHIP, PARTNERSHIP, CORPORATION, OR SOME OTHER FORM?

If you are organizing or reorganizing a business, you want to consider all the legal forms available to you.

The most generally used are the corporation, partnership, and sole proprietorship. Variations of these to overcome difficulties in particular problems are limited partnerships, joint stock companies, joint ventures, syndicates, and trusts.

The *tax advantages* of each of these forms are discussed in Chap. 4. Here are the advantages of each of the legal forms you will want to talk about with your lawyer. Ease or type of organization may be essential in one case but a negligible factor in others. Similarly, other checking points are vital in one case and unimportant in others.

The proper selection of the form of organization will depend upon such factors as—

How and when you propose to divide profits
What liabilities you are willing to assume
Ability to raise capital under the various forms
Tax advantages and disadvantages

Here are some notes to help you find the right way to do business.

What business forms can you use?

One form is an enterprise operated by a *sole proprietor*. It does not share profits with others. It is easiest to get under way.

It has singleness of control and a maximum of centralized authority—quick action. An individual can do business almost anywhere in the United States. He is not bound by restrictive laws, corporate charter, or partnership agreement—he has freedom of action.

Other advantages of this form are—

It affords the greatest amount of privacy
Its responsibility is directly fixed
It gives greatest personal contact with customers, employees, etc.
It often has very real social-security and income-tax advantages

But it does have disadvantages:

Death or disability of proprietor means drastic changes
Personal life, domestic or economic, affects the durability and stability of the organization
Natural limitation of the ability and energy of a single individual restricts its size and growth
It has unlimited liability for its owner

The advantages of the *partnership* form of organization lie in the ease and speed of its formation. The cost to set it up is small.

Unlike the corporation, it has no limitation by charter. There are only self-imposed limitations by agreement. It usually can secure a greater aggregation of capital than the individual proprietorship.

Other important advantages are—

It obtains specialization of functions by partners
The policy making is less one-sided—more balanced
It is worthy of greater credit because of personal liability of partners
It maintains a better personal relationship with customers, employees, and others than does a corporation
It has opportunities for advancement that can be more readily offered to "key employees"

But it does have disadvantages. All important is that: death, withdrawal, or bankruptcy of a partner and many other unpredictable elements end the life of partnership; there are difficulties in divorcing a partner from the partnership; there are possibilities for lack of unanimity among partners and serious complication if a deadlock occurs. Other important disadvantages are—

There is often divided responsibility
Vicissitudes in the personal fortunes or life of a partner seriously affect its continuance
The partnership interest is not readily marketable
It has limitations on organization growth because of the natural limit on the number of partners who can effectively work together
Additional capital cannot be raised so easily as in the corporate form—the admission of new partners may be necessary
There is unlimited liability of each partner. He may be required to use his personal assets to pay the firm's debts. However, it is possible to obtain insurance against that liability

Some of the problems in partnerships are avoided by *limited partnerships.* They have the advantage of limiting the liability of those who do not want to be general partners. Creditors must be notified of the limited liability provided in the partnership articles.

The advantages of the *corporate* form of organization are many.

Liability is limited to the amount of stock issued. This advantage accrues primarily to stockholders in large corporations, interested in investment only. In a "close" corporation, owners may be made personally liable by having to indorse all loans made by the corporation. (Of course, proprietors or partners can protect themselves from liability by appropriate insurance.) Other important advantages are—

There is continuity of existence regardless of any change in ownership through transfer of stock. This, too, is a feature that is desirable from the viewpoint of investors rather than of those who are seeking to organize a business

Management continues despite change in ownership

Interest in the corporation can be readily transferred

New or additional capital may be more easily acquired

But the corporate form has many disadvantages. It must file many reports and various tax returns, is subject to much Federal and state regulation, and may be expensive to set up. It is difficult to expand into other states. The scope of business activity is limited by the corporate charter, although this difficulty can be avoided by making the scope of the business very broad in the original charter or by amending the charter.

Joint ventures and syndicates are often used. They are temporary in character, making possible sharing the risk of special ventures. But they have many disadvantages:

Their organization is unstable and vague

They have no real legal entity

They have no accruing goodwill

Their ventures smack of undue gambling risks

Syndicates may be suspected of violation of antitrust and regulatory rules

How to operate a partnership

Talk this page over carefully with your lawyer.

In the absence of agreement with your partners, the law provides rules to find your rights and obligations. Better get your partnership agreement in writing, and include in it at least—

The kind of business to be conducted

The amount to be invested by each partner

The division of profits and losses

The powers and duties of each partner

The compensation, if any, to be paid to each partner

Provision for partners' drawings

The division of assets in case of dissolution

The duration of the partnership and the manner in which it is to be dissolved
Provision for the withdrawal of partners and the admission of new partners
The manner in which differences of opinion are to be settled
Anything else of importance about which there might later be some dispute

Don't consent to habitual violations of any part of your agreement unless you want to lose those rights permanently.

You want to exercise the utmost care in the choice of your partners. Their power to obligate the partnership is exceedingly broad. Their acts may cause you to lose, not only your investment but your private property as well. Private agreements among the partners limiting their powers are binding only on those creditors who receive notice of the agreement. After you have selected your partners—

Observe the highest good faith toward them
Be sure to exercise the proper care and skill in the performance of your duties—otherwise you will have to make good any loss
Don't use the partnership business or property for your own profit or advantage
Don't engage in any competing business without their consent

Remember that your rights as a partner do not include the right—

To do anything that would make it impossible to carry on business
To dispose of the partnership's goodwill
To confess a judgment against the partnership
To make an assignment for the benefit of creditors
To submit the partnership rights or obligations to arbitration

Generally, a partner cannot incur new partnership obligations after the partnership has been dissolved or to do anything else except wind up the business. The partnership is automatically dissolved and a new partnership agreement is necessary when any one of the partners is expelled, sells his interest, withdraws, dies, or is declared bankrupt.

When you can't get your partners to agree on dissolution, a court will dissolve a partnership if—

A partner is shown to be of unsound mind or otherwise incapable of carrying on his duties
A partner has been guilty of such misconduct as to make it impractical to carry on the business with him
The business can be carried on only at a loss

In dissolution, the firm's assets will be marshaled and applied first, to debts of outside creditors; then to debts of partners; then to capital of partners; and finally to profits, if any. In receivership of the partnership, partnership creditors have first right to partnership assets; private creditors

have first right to partners' private property; and partners whose assets are applied to pay debts of other partners have the right of contribution from those other partners.

If you want to limit your losses to your investment in the partnership, form a limited partnership. Check with your lawyer on: how to conform with the formalities as to organization; how you subject your private property to liability for partnership debts if you take an active part in the management of the business or if your name appears in the firm name.

If you want to withdraw from the partnership, don't do it in violation of your agreement. Don't withdraw in such a way as to injure your partners, unless you are prepared to make good the damage you have caused. You should notify the partnership creditors of your withdrawal. Or advertise it in a newspaper of general circulation in the place where you are doing business. If possible, try to get the creditors, your partners, or both, to release you from the partnership debts.

How partners figure their Federal taxes

Partnerships do not pay a tax. They merely file an information return. That tells the Treasury of the proportionate share of profits earned by each of the partners. This also shows some financial condition data to help the Treasury study of family partnerships. The partnership computes its net income (even though it pays no tax as an entity) in a manner similar to that of an individual.

Partnerships are not entitled to any personal exemption, credits for dependents, or the standard deduction given individuals. But partners get all these credits in making their own returns.

As a general rule anything a partner gets from his company is part of the partnership profits. It is not taxed *unless there are profits.*

How each partner makes up his tax return

Each partner reports, on his own tax form, his proportionate share of the ordinary income of the partnership. This will *not* include charitable contributions, capital gains, and exempt income. These do not enter into a computation of partnership income on the information report filed by partnerships. The partner includes on his return his share of ordinary income, plus his share of the following items of partnership income and expense:

Charitable contributions. These, plus his own contributions, may be deducted from the partner's total income. But the aggregate contribution cannot exceed the 20 to 30 per cent limitation

Long- and short-term gains and losses from the sale or exchange of part-

nership capital assets. These are added to the partner's own items of the same nature to find his tax. Each partner gets a $1,000 reduction of ordinary income as a result of these combined losses. This may be of great advantage to members of a partnership. But you get only one $1,000 reduction—not one for partnership losses and one for your own losses. Any doubt that a partner's own capital gains may be reduced by his share of partnership losses has been eliminated

Exempt income. It remains exempt to the partner. Partially exempt income becomes the partner's own income. This concerns income subject only to surtax and not to the normal tax. If a partner takes a credit here, it cannot exceed the partnership net income. If the partnership has elected to amortize these government bonds, each partner's share of interest is reduced by the proportionate amortization

Net operating loss. This is not allowed to the partnership. In computing the individual partner's net operating loss he takes into account his respective share of the income and losses of the partnership

A partner's proportionate share of the partnership profits is part of his gross income. He reports the income even though, in fact, it has not yet been distributed. He reports his partnership income even though he is on a cash basis while the partnership is on an accrual basis, or vice versa.

A partner can report *salaries and interest on capital contributions* received from the partnership as salary and interest if they are guaranteed regardless of profits.

For tax purposes, each partner can deduct his usual exemption on his own individual return. He would also be entitled to his share of the partnership's—

Credit for interest obligations
Credit for taxes paid on bonds
Credit for taxes paid to foreign countries or possessions of the United States

If a partner pays business expenses he gets a deduction unless: his distributive share from the partnership is reduced by the same amount; another partner reimburses him for his share of the expense. A partner may deduct legal expenses paid in defense of a suit for: misconduct in the operation of the partnership business; failure to account for the profits earned by the partnership.

Sometimes operating partnerships are taxed as corporations

Business groups often call themselves partnerships when, in fact, they are corporations. For tax accounting, partnerships may be taxed as corporations, unless it is shown—

That the partners "contribute" to the organization in the form of capital *or* services. These contributions must be real, though some partners may be inactive

That profits and losses are shared on a definite basis

That there is both joint and several liability for debts. Limiting the liability of a partner approaches the corporate form

That the partners' participating interests cannot be sold or inherited. Death ends the partnership. Where these interests can be disposed of —as can shares of stock of a corporation—the organization may be taxed as a corporation

That the partners are directly responsible for the conduct of the business—each partner being agent for the others. The managing partners may be representatives, not agents, of the others (as the directors of a corporation are representatives of the stockholders). Here there is danger that the Treasury will disregard the partnership form

That the partners act really as coproprietors. If there is strong centralization, characteristic of the corporate form, the Treasury disapproves. It will tend to find that a corporation rather than a partnership exists

Turn to page 73 to see how a partnership can elect to be taxed as a corporation while still retaining its true partnership form.

As pointed out on page 59, a partnership can be used as means of splitting income so as to free each distributive share from the high surtax rates.

A husband and wife, father and son, etc., may form a real partnership. This is true even though it is conceived as a means of tax reduction. The only objection is where the partnership is a sham and a "mere paper reallocation of income among the family members."

A real gift of a partnership interest will be recognized. But all the facts at the time of the gift will be scrutinized. That the donor keeps the big part of managing the partnership or is trustee for the new partners will not of itself knock out the new arrangement.

So long as capital is an important income producing factor and a reasonable allowance is made for the salary of the donor-partner, a gift of capital creates a valid partnership, even though—

The family members really take no risk. Capital that comes by gift creates a real partnership

They do not contribute control, policy making, and management

They do no important work—in businesses where capital would normally be an important income producing factor

In some businesses, capital is the all-important earning factor; in others it is skill and knowledge; in others, downright hard work, long hours, etc. In personal service businesses, the family member should play an important part in producing the partnership earnings by doing *regularly*—

Services in contacts with customers or suppliers
Running a part of the business
Regularly conducting the office
Services wholly independent of what the managing partner does

Your partnership reports on its own tax year

A partnership's tax year may be different from that of the partner. Then the partner includes in his tax year his share of the partnership income for the partnership tax year which ends in his tax year. For example, one partner has a tax year ending Dec. 31. The partnership year ends June 30. The partner includes in his Dec. 31 tax return, the partnership earnings for the period ending June 30.

Dealings between you and your firm

When you deal with your firm, you have to be aware of the tax consequences of these dealings:

Services. Where the partnership deals with a partner as an outsider and charges him for services rendered, it is income to the partnership. The partner will report his share of the partnership income, although it may include payments he has made to the firm. The partnership is recognized as a separate entity. If it is income to the partnership, it is income to the partner, even though he may have contributed to the income.

Losses. Deductions for losses are denied where there is a sale or exchange of property between a partnership and a controlling partner. A controlling partner is one who has more than a 50 per cent interest in either the capital or profits of the firm. You meet the "over 50 per cent test," if you are considered as owning the interest of the other members of the partnership who are related you. Such partners include your wife, children, grandchildren, parents, grandparents, brothers, and sisters.

Know the tax problems on the distribution of partnership assets

Considerable caution is necessary in partnership distribution of assets upon liquidation. Partnership profits, salary, or interest on capital accounts are determined at the end of the partnership year. They are treated as ordinary income to the partner in the year ending with close of the partnership tax year—not that of the individual. All items are treated as distribution of partnership profits. On other partnership distributions a distributee partner generally recognizes no gain or loss on his receipt of a partnership distribution. And this is true whether or not the distribution is a current or partial liquidation payment or a payment in complete liquidation. However, there are several important exceptions to that general rule:

In a current distribution or one in partial liquidation, a loss is never recognized, but gain is recognized when the cash distributed exceeds the basis of the distributee's partnership interest. For example, where a partner with a partnership basis of $10,000 receives a distribution of $11,000 in cash, a gain of $1,000 is recognized and taxed at capital-gain rates. But no gain is recognized where he gets $3,000 in property and $8,000 in cash. However watch out for this problem: Where a partnership holds appreciated inventory or unrealized receivables or both, a disproportionate distribution of assets may result in tax to both the distributee partner and the nondistributee partners.

In a complete liquidation, as in the case of a current distribution, no gain is recognized except where the cash received exceeds the partner's basis in the partnership. Loss is recognized where the distribution consists solely of money and unrealized receivables or inventory or both and where these items exceed the partner's interest in the partnership. But loss is not recognized if property other than inventory or unrealized receivables are distributed. Here, too, you have to watch out for the tax consequences arising out of a disproportionate distribution of assets When the partnership assets include unrealized receivables and appreciated inventory.

When you finally dispose of the distributed property, you have to determine how the sale or exchange is taxed. The general rule is that the character of the gain or loss on the disposition of distributed property is the same as would be realized by the partnership if it had made the disposal. That is, where the sale of property would be treated as ordinary income if made by the partnership, the sale of that property by the distributee partner is also taxed as ordinary income. So where you get a distribution of unrealized receivables and you later sell them, any gain or loss realized on the sale is ordinary gain or loss. The same rule holds for the sale of distributed inventory unless it is sold after you have held it for more than five years. In this case, you would realize capital gain or loss.

When the interest of a retiring partner or of a deceased partner is liquidated, ordinary income is realized on the amount of the distribution attributed to the partner's distributive share of income, guaranteed salaries, or interest. Capital asset treatment is extended only to the value attributed to the partnership interest. And for this purpose, the partnership interest does not include payments for unrealized receivables, which if present will be reflected as ordinary income. However, if goodwill is present, it may be included as part of the partnership interest if the partnership interest provides for such payment. But it cannot be more than the reasonable value of the distributee partner's share of the partnership goodwill.

If a partnership interest is sold to an outsider or to the remaining partners, the law says that there is either a capital gain or loss with this exception:

To the extent that the partnership holds unrealized receivables or appreciated inventory, part of the gain or loss is treated as ordinary income or loss. Appreciated inventory is inventory whose value exceeds 120 per cent of its basis to the partnership and 10 per cent of the fair market value of all the partnership property. Unrealized receivables are rights to payment for goods or services that have not been reported in income.

How to operate a corporation

If you are doing business as a corporation, ask your lawyer to tell you how you must conduct the business. The powers of the corporation are expressed by its charter. If you want to do anything not authorized, you must amend the charter. Before doing business in another state, find out whether it is necessary to obtain permission from that state and, if so, how to go about it. Failure to do so may make it impossible to collect bills and subject you to other penalties. You should—

- Adopt bylaws outlining the rules and regulations to be followed
- Make sure that your board of directors is legally qualified and that you have the required number
- Find out if you have the officers the law requires you to have
- Hold the stockholders' and directors' meetings required by the state law or your bylaws
- Keep the stock books and other records required by law
- Make it a practice to keep minutes of stockholders' and directors' meetings and to put important decisions in the form of written resolutions

In transferring stock you should be sure to see that it is properly indorsed and witnessed and that the transfer is recorded in the stock record books. Don't transfer stock of a deceased person without an authorization from your state.

In your choice of directors, remember that for all ordinary purposes they have the power to run the business without interference from the stockholders. The powers of a director usually cannot be taken away by an agreement to act merely as a "dummy." They are not responsible for honest errors in judgment. What are the duties of the directors?

- They should attend meetings regularly and make it their business to know what is going on
- They cannot make secret profits or commissions out of any business transaction by the corporation, nor use their position to obtain any unfair advantages
- They should not unlawfully borrow money from the corporation or authorize loans to other directors, officers, or stockholders
- They can pay dividends only out of profits and not out of the capital invested in the company

Generally, they should not take part in any acts that are unfair or beyond the powers of the corporation
If they cannot agree with the action taken by the majority, directors must see that their dissent is noted or be ready to assume the liabilities provided by law

Directors and officers should know that minorities may take advantage of their legal rights to injunction or damages in cases of:

Fraudulent, illegal, or negligent acts of directors or officers
Violation of their rights in reorganization, liquidation, merger, etc.
Losses sustained through acts not authorized by the charter
Wrongful withholdings of dividends
Secret profits made by directors or officers
Disadvantageous contracts entered into with other organizations in which the directors are interested
Wrongful increases in officers' or directors' salaries

Stockholders have the following rights:

To have a certificate of ownership of shares
To transfer ownership to others
To vote for directors
To vote on questions involving the corporation's property
To restrain the corporation from performing acts beyond its authority
To protect their interests against wrongful acts by the majority
To receive dividends that are declared
To subscribe for new issues of stock in the proportion of their present holdings
To share in the proceeds of the dissolution of the corporation

Know the securities a corporation can issue

The various types of stock that can be issued and the kinds of dividends you can pay are—

Par- and nonpar-value stock. The fiction of a declared value is eliminated by the no-par stock. This permits sale of stock at different times at fair-value price, thus overcoming problem of selling par-value stock in fallen market. But it may raise litigation by stockholders claiming impairment of their interest when additional stock is issued. The Federal issue stamp tax on par- and nonpar-value stock varies. Some states treat nonpar-value stock as though it had a par value of $100, which may create large tax burden. You should consider also the Federal and state taxes on stock transfers

Preferred stock. The right to receive a dividend before profits are distributed to common stockholders is usual with preferred stock

Participating and nonparticipating preferred stock. Sometimes this stock can participate in profits after payment of the dividend to preferred stockholders

Cumulative and noncumulative preferred stock. Dividends not declared in any year will generally accumulate. They must be paid before profits are distributed to common shareholders

Redeemable stock. The right to redeem is in the corporation. The price may be fixed or possibly determined by specific conditions. The price usually includes all dividends in arrears

Convertible stock. The right is usually held by the stockholders, but may be held by the corporation, to convert into some other stocks or bonds. If the right extends to convert to bonds, the option is usually held by the corporation

Guaranteed stock. Dividends are guaranteed by some corporation other than the one that issued the stock—for example, by a parent company to the stockholders of a subsidiary company

All sorts of dividends can be paid to stockholders. Some are—

Cash dividend—paid in cash

Stock dividend—where additional stock is issued to stockholders on a prorata basis

Liquidation dividend—paid out of the assets of the corporation upon dissolution

Scrip dividend—paid in notes that are to be redeemed at a later date, usually in cash

Consent dividend—where the stockholders consent to be taxed as if they had received a stated sum of money, but get no actual payments of any kind

Elective dividend—where stockholders may take cash or a stock dividend at their option

Dividends in property—for example, capital stock or bonds of the distributing company; other shares of stock or bonds owned by the company

The power to declare dividends rests solely with the board of directors, who can declare them only out of surplus. It is necessary to examine the law of your particular state on this point. Generally, past deficits from operations must be made up before a dividend can be declared. In most states, the directors are personally liable to creditors if capital is impaired by declaration of a dividend not out of surplus. But this rule does not always apply to companies engaged in an industry involving wasting assets, as natural resources.

How corporations figure Federal taxes

Federal corporation-tax problems are complex. Political expediency, plus an effort to deal equitably in special cases, plus unwillingness merely to increase rates when new taxes are imposed, have given us all sorts of labels, mechanisms, and technicalities.

In operating a family corporation, beware of becoming a personal holding company. These are popularly referred to as "incorporated pocketbooks." They are subject to a surtax of 75 to 85 per cent. Your corporation will be classed as a personal holding company if it fits the law no matter how honorable your actions and innocent your intentions. Even legitimate business reasons do not help. If 50 per cent or more of the corporation's stock is owned by five or less people, *and* 80 per cent of its gross income is from interest, royalties, security or commodity transaction gains, income from estates and trusts, annuities, dividends, personal-service contracts, or rents under certain conditions—then your corporation is that burdensome creature, a personal holding company.

If you fit into one of the following types of businesses, check this problem before you incorporate. For the reasons given here, these types of businesses should *not* incorporate:

Family partnership in the investment business
A speculator or trader (not a dealer) in securities
An engineering or similar partnership. The designation of one of the members to perform a contract would risk personal service standing
A company that collects for use of its building, equipment, patent, license, etc., from one of its members whose ownership is 25 per cent more and more than 10 per cent of the company's other gross income is held to be personal-holding-company income.

This part of our law is intended to discourage individuals from incorporating their income-producing properties or abilities to avoid the higher surtax on individuals. It was also intended to "pressure" existing companies to distribute their total income, to dissolve, or to abandon the characteristics which make them holding companies.

Your corporation may be subject to the prohibitive surtax if two requirements exist—one involving the source of its gross income and the other concerned with the stockownership. If you meet these tests you must then determine the net income under the special rules in this section. It is quite different from the normal-tax net income.

The basis for the surtax is the net income which is undistributed. You subtract certain credits from the net income and the balance is subject to this special tax.

This surtax is imposed in addition to corporate normal and surtaxes. But

personal holding companies are exempt from the surtax on corporations improperly accumulating surplus explained below.

How to avoid a tax on failure to pay dividends

Corporations are often used to accumulate surplus for the purpose of helping stockholders avoid the payment of a tax on dividends. The penalty tax is imposed to force distribution of corporate earnings. It is avoided by showing that the accumulation was *not* for the purpose of avoiding a tax on the shareholders. This tax is distinct from all other corporate taxes. It is imposed *in addition* to the ordinary income tax and surtax.

There are two sides to the problem of building up a corporation's surplus by not paying dividends.

One side of the problem concerns the stockholders who are taxed in the high-income tax brackets. They get very little out of a dividend payment, especially when the individual tax rates go as high as 91 per cent. To avoid this bite, corporations can be used to hold on to profits until a payment becomes less costly. And we can accumulate with complete safety as long as the accumulation does not top $60,000 . But over this amount, we may run smack against a penalty tax for an improper surplus accumulation. This tax is distinct from all other corporate taxes. And it is imposed in addition to the corporate normal and surtax rates. We may still avoid the penalty if we can show that the accumulation meets the reasonable needs of the business.

What reasonable needs are leads us to the second side of the problem. How far can earnings and profits be accumulated to meet needs without a business being hit with the charge that its real purpose is to avoid the individual surtax rate imposed on the stockholders?

The law says that reasonable needs can include *reasonable anticipated* needs of the business. This covers your future plans for buying buildings or equipment which are specific and definite. It does not apply when the plans are vague and indefinite or when you indefinitely postpone the execution of those plans.

Important: There is no requirement for an *immediate investment* of corporate profits as long as there is evidence that the future needs of the business call for the accumulation.

If you use your funds for the reasonable and current needs of your business you need not worry about distribution of dividends. But when your surplus is over $60,000, you may court trouble if—

Cash piles up beyond prudent requirements
Investments are made in securities, etc., of businesses unrelated to your own needs
Earned surplus has accumulated in substantial amounts for prior years
There are dealings between the corporation and its shareholders, *e.g.,*

individual withdrawals by the shareholders; personal loans to them; or the expenditure of funds for the personal benefit of shareholders

There is too little dividend distribution in the light of the nature or financial position of the company

Expansion and improvements are contemplated but *not* actually made

There is use of the corporation entity for incorporating the "talents" of an individual or to hold his personal securities

There is investment in assets having little direct relationship to the business

The same facts often seem to produce different tax results in decided cases on this part of the law. The decisions deny a tax where evidence establishes an absence of *purpose* to accumulate income or avoid surtax. Most of our decisions have arisen on facts establishing that—

The purpose of accumulating unreasonable funds, condemned by the law, is obvious

Unnecessary loans exist between corporations and stockholders

Accumulations are really for the benefit of the stockholders rather than the corporation

There is absence of a specific plan, objective, or contingency which, in the exercise of good business judgment, demanded the accumulation of the earnings and profits

There is a corporate practice of accumulations adopted for mere convenience and without tax significance when adopted—you may have difficulty if it is continued. You are then open to the charge of avoiding surtax on the stockholders. A court may conclude: whatever the motive *when* the practice of accumulations was adopted, the purpose of avoiding surtax induced, or aided in inducing, the continuance of the practice

Accumulations are too large for the fair needs of the business. This is so even though the profits arise out of normal business. If business dividends are too small it may be alleged that the purpose was to accumulate profits for the benefit of shareholders. The fact that the taxed surplus was accumulated beyond the reasonable needs of a business, and the further fact that stockholders, who were wealthy men, saved a large income tax that would have been imposed upon them had the taxed surplus been distributed, are evidence enough to uphold the tax

What reasons can you use to avoid paying dividends? The job is to prove that: you did not permit earnings or profits to accumulate beyond the reasonable needs of your business; your corporation was not availed of for the prohibited purpose. One recent case held that it was proved by convincing the court that the company adopted, by appropriate corporate action, a policy of accumulating a part of its net profits each year to be added to surplus "so that the company have funds for expansion or any

unseen depression that might occur." This policy was carried out in all the taxed years. The court held that a corporation's earnings were not accumulated beyond the reasonable needs of the business where it is shown that the purpose of accumulation is: to make improvements which will add to the convenience and efficiency of operation of the business; to accumulate some cash reserves as a bulwark against future depressions; to meet unknown risks.

Decisions suggest there is a chance to eliminate the penalty if there is anxiety about losses ahead. Apparently you may prove the need for accumulation by what happened in the period after the dividend years. And you may fairly use any of the following as a good basis for small payments of dividends:

Needed improvements cannot be financed without borrowing
Changing laws or regulations will require more money for financing customers or your purchasing. Or the change may permit restoration of your inventories or other assets to their normal status rather than the depleted state which the regulations or law required
Your earnings available for distribution are not fairly stated—in view of current cost to replace fixed assets. In an era of sharp price advances, replacements of plant and equipment require much more capital than the accumulated reserve for depreciation. The accumulated depreciation of low-cost assets cannot meet higher replacement costs
Small surtax would have resulted to stockholders if dividends had actually been paid
Accumulations are essential to provide for proved expansion of the business
Surplus was set aside in order to have it available for depressions reasonably expected or to meet the troughs of normal business cycles
Funds were necessary to construct a new plant
Funds were necessary to take care of new business
Funds were necessary to invest in a different character of business
Funds were necessary to make required advances to a related company
Maturing obligations' payments made dividends impossible
Sales on long-term credit basis made dividends impossible
Poor financing conditions (following accepted trade practices) made dividends impossible
Repayment of loans are made by stockholders. Particularly where their loans aided the corporation to meet interest and principal payments
Illegality of dividend declaration prevented payment
Possibility of operating losses required accumulations
Existence of bona fide obligations needing annual amortizations is proved
Retention of large cash sums is proved to be necessary to meet specific emergencies
Advances have been made to suppliers to insure a continuance of opera-

tions. In one case there were substantial advances to another company engaged in a similar business. Here supplies and raw materials had been purchased from each other to the advantage of both

Sales have been made to one or few customers whose loss would require extensive promotion to get new business—and there is a possibility of losing the customer

Increasing competition requires reserve to take care of losses or extra costs ahead

Legislation is threatened which will be adverse to the business

Violent upswing in costs of raw material or labor is expected

Shrinkage in value of the assets is not included in the income on which the tax is based, due to inability to take anything but realized losses as deduction in tax return

What steps can you take in the management of a business if you have accumulated large liquid earnings of over $60,000? Perhaps your equipment and fixed-asset purchase orders can be placed now to avoid the penalty. Or at least get a complete, written plan showing just why you desire to retain earnings. Our cases hold that any impairment of capital must be restored before any earnings are available for distribution to the stockholders. Perhaps you cannot be taxed for unreasonable distributions in these instances. It is essential to ascertain whether you have any real surplus which can be used for distribution to the stockholders. Often our older companies find they do *not* have the accumulation they assume. You may avoid the surtax if you have no "accumulated earnings." Beyond these, the following steps may aid you to avoid the penalty tax if you do not distribute earnings:

Check normal business steps to be taken like: speeding deliveries to your customers; cutting your cash and piling up inventories and receivables; buying all possible inventories or supplies needed for current production, to cut your cash; avoiding advance collections from customers, to keep your cash down

What about converting your tax year to your natural business year? That may reduce your year-end cash balance. See if you ought not to change your reporting year. It should end at a point when your cash is lowest

Make sure your directors' meetings fully explain by convincing reports and records of the discussions that led to failure to pay dividends

Have the directors approve creation of actual reserves required; state the possible liability or loss for which you are providing

See if your stockholders really would have a surtax by your payment of dividends. They might not, because of losses. In that case, you are not avoiding the surtax and will not be penalized if you do not pay dividends

Check to see if you should dissolve the corporation and operate as a partnership. Most likely you will have a capital gains tax. But that may

be much cheaper than the penalty tax on undistributed earnings. (This assumes you have no substantial goodwill on liquidation.) Liquidation is repeatedly advised to avoid the penalties in this section. The accumulated earnings distributed in a liquidation secures a full dividend credit. It may wipe out the tax on undistributed income due for the year. It may be a very important move for some companies. This step should not be taken with young or new corporations. The Treasury might urge that the liquidation was part of the plan when the company started

How can you pay dividends to avoid the penalty? If cash is paid, the credit is the full dollar amount of the dividend. The credit is allowed only if the dividends are *paid* before the end of the year. Declaration is not sufficient.

You get no credit if the dividends are not paid *pro rata to all* stockholders of a class. If you distribute property, the test for prorata distributions is concerned only with the value of the property to the recipient—not the cost of the property to the company.

Maybe you would be willing to pay this tax. This penalty tax rate on corporations is often considered relatively low, and hence it may sometimes pay you to risk the tax.

The rate is 27½ per cent on the first $100,000 of "undistributed earnings" (a special calculation, set out in the law). Anything over that is taxed at 38½ per cent.

Individual tax rates run up to 91 per cent. Therefore it is often figured that the combination of the tax of 27½ or 38½ per cent on the undistributed profits, *plus* the tax of 25 per cent that comes with eventually liquidating a company and giving all the assets to the stockholders will be much less than the tax that would be paid by the shareholder receiving the dividends.

As a result some stockholders may risk the tax. These stockholders figure that the tax plus the cost of liquidation will be less than the cost of a dividend to them.

How corporations tax-wisely deal with stockholders and bondholders

When a stockholder advances additional monies to his corporation, he may want them treated as a loan. If the advance is a contribution to capital, the cost basis of his stock is increased. The stockholder's intention is very important. That may determine whether the payment was made to increase his stock investment—or to create a creditor-debtor relationship with his corporation. There is a loan only if the advance is made with expectation of repayment, even though—

The corporation is in financial difficulty
The loan is made by sole or controlling stockholder

Redemptions of stock often involve the charge that a taxed dividend is really being paid to the stockholder. Then, of course, the stockholder may lose the opportunity of capital-gain treatment and be taxed as on an ordinary dividend. Where the dividend charge can be avoided, the redemption of stock is considered a sale by the shareholder of his stock to the corporation. In such case, he has capital gain for the excess of what he receives over the basis of the stock he gives up.

Although the law does not specifically explain when a redemption is essentially equivalent to a dividend, it does set out some specific situations where, if you meet the rules, you can get capital gain on redemption. Consult your tax adviser when you plan any kind of stock redemption or liquidation. He can show you how your plan can meet these rules.

In this area, we also want to be wary of the tax traps awaiting a stock deal which comes within the collapsible-corporation rules. Here, a sale of stock or distributions in liquidation that would otherwise give capital gain can give ordinary income if a collapsible corporation is involved. The collapsible-corporation rules are designed to prevent capital gains in a situation like this: A corporation is formed to build a house, produce a moving picture, buy inventory, or build or produce anything else. When the building or production is completed, it is assumed the value will increase. Instead of the corporation selling the product and realizing the profit, the stockholders sell their stock or the property is liquidated to the stockholders. In this manner, the stockholders hope to get capital gains through the increased value of their stock or a capital gain on liquidation with a resale of what is distributed at no gain. The collapsible-corporation rules prevent this result.

If you are going to buy out another stockholder, do not assume you can then get your corporation to acquire the stock from you. You must have the stockholder deal directly with your corporation. That gives these advantages:

Your selling stockholder still gets a capital gain, he thus secures his income at bargain rates. For him to take what is due him as dividends might be very expensive. That might permit you to buy his stock very advantageously

You avoid a tax to yourself at ordinary dividend rates if you try to pay for the stock out of money taken from the company. If you buy and then redeem, still holding on to the rest of your stock, that is likely to be termed a dividend

Paying out a stockholder from the company cuts its cash. That may diminish the risk of assessment of the tax for failure to distribute profits

Stockholders of a corporation frequently enter into agreements restricting the sale or other disposition of their stock. There are many business reasons for doing this. Among these are—

Ensuring continuity of control of the corporation
Ensuring stability of management
Preventing outside interests from becoming stockholders
Interesting and retaining able officers and employees
Fixing the price upon disposition of the stock after death of the holder
Fixing the mechanics for disposing of stockholder's interest

Many difficulties are involved in making these agreements. For example, the disposal price cannot be set at a figure out of the reach of the survivor. On the other hand, it cannot be set so low that it injures the decedent's family. Unless the agreement is completely effective, a dissatisfied executor may be inclined to contest it.

In drafting restrictive agreements, if you desire to limit estate and gift tax evaluation to the agreed price, you should do these things:

Eliminate opportunities for stockholders to transfer stock to other persons before the option holders can act
Do not permit the stock of a stockholder-decedent to be transferred to his family without giving rise to the option
Do not make transfers dependent upon consent of the board of directors. In a closely held corporation, this will leave in doubt when the approval will be had
Indorse stock certificates with a notice of the agreement restricting disposition of the shares
Include the corporation as a party in the agreement, even if no option runs to it
Deposit shares in escrow. This limits possibilities of nonperformance and litigation
Make option effective at the election of others, if one attemps to transfer in violation of the agreement
Make sure terms like "book value" or "earnings" of the corporation are carefully defined, if price is dependent upon them
Provide for dilution of the stock by stock dividends, recapitalizations, mergers, extra ordinary distributions, etc., if a definite price per share is fixed. Otherwise it may be argued that the practical effect of the agreement was uncertain—because the price was dependent upon contingencies not considered
Avoid circumstances permitting the agreement to be indirectly invalidated. In one case the restriction was in the bylaws and would be eliminated by a change in the bylaws. Be sure a dominant stockholder cannot modify or remove the restriction by forcing an amendment, waiver, or even abandonment of the agreement
Fix the events which make the option operative
Do not permit sale of the stock to another *even* with the condition that he hold the stock subject to the same options as the transferor. This weakens effectiveness of the agreement

Do not set a number of option prices at different amounts dependent upon varying factors. That places an additional burden of fixing the price. Set a single option price to be used in all circumstances

Remember that grant of unilateral options to employees sometimes limits value. But it must be shown that: the option was given to encourage the employee in continuing with the corporation; his services were needed in the business

How to finance your corporation and get the greatest tax deductions

Sometimes bonds are preferable to stock in financing your new corporation. You get an interest deduction for bonds and not for stock. You generally can pay off the bonds without tax liability attaching to the transaction. If you redeem stock without disturbing the relative interest of stockholders, your payments might be taxed as dividend distributions. But the same theory does not apply to *bond* redemptions.

How do you find out whether a given amount paid into or left in the business of a corporation by stockholders is a debt or is capital stock? Stockholders' money left in the business may be there either for investment or as borrowed capital. That depends upon the conditions attending the advance.

Modern corporate practice frequently makes use of hybrid forms of securities with overlapping characteristics. To discover whether you have an interest deduction, it is necessary to determine whether a particular security is a proprietary interest or a debtor-creditor relationship. For example, so-called "preferred" stock, which ranks with or prior to the interests of the general creditors, may be a debt. Whether outstanding certificates designated by such names as "debenture preferred stock" or "guaranteed preferred stock" are borrowed capital depends upon this point: whether the holder has a proprietary interest in the corporation or has the rights of a creditor, determined in light of all the facts. The name borne by the certificate is by no means controlling.

The issue in most of these cases is whether the "interest" payments are deductible. If they are "dividend" payments, they are not deductible. The Treasury may claim that reorganization plans, under which the so-called debentures were issued, serve no business purpose of the corporation—that the transaction is lacking substance.

But this has no bearing upon interest deductions. If the instruments contain the following, they are not preferred stock and the payments made for interest are therefore deductible:

Interest rate is fixed
Payment date of interest is fixed

Payer is under a definite promise to pay
Payment is not dependent upon earnings
Payee has priority to stockholders on dissolution
Upon default, all rights of payee may be enforced by suit
Holder has no voice or vote
Maturity of debt is definite—in 5, 10, or 20 years, or some other reasonable date in the future
Obligation gives the holder no share in the company's assets, or in its net assets on liquidation

Sometimes companies issue bonds in a recapitalization. Or they may try to convert stocks to bonds. That may produce a tax to the receiver of the bonds. If the issuance of any type of security can be accomplished by a dividend, then it cannot be given tax immunity by calling it a recapitalization.

A reclassification or other realignment generally cannot get you tax freedom if there are accumulated earnings.

What is controlling is that a new arrangement shall not give the appearance of accomplishing a distribution of earnings. A corporation which has undistributed earnings may create new corporate obligations. They are transferred to stockholders in relation to their former holdings. That produces the same result as a dividend of cash earnings. This usually cannot obtain tax immunity for the stockholder. You do get tax freedom in a recapitalization if—

It is designed to accomplish a general reshuffling of capital structures of a business—for example, adjustment of securities by voluntary agreement of creditors and stockholders—or a reshuffling of securities for a business benefit or purpose like—
- Improving the credit of the company
- Making a bank loan possible
- Reducing corporate fixed charges
- Eliminating an obligation to retire securities for cash at fixed dates
- Making a market for corporate securities
- Improving the corporate financial structure
- Eliminating harsh preferences in existing stocks
- Getting a wider market for stock
- Making possible corporate redemptions to its advantage
- Providing financial encouragement to employees or management by increasing possibility of income from stock owned by them

Securities are issued for a sound corporate (not shareholder) business purpose, and pursuant to a plan of recapitalization; for example, when—
- Bondholders exchange their bonds for preferred stock
- Preferred stock is given up for exchange into common or preferred stock of the same company

There is a good business reason—even when there is a substantial shifting of rights of stockholders. One case permitted a group of common stockholders (an older group desiring to relinquish management) to give up their common stock to another and younger group and to take preferred stock in exchange

10. HOW TO OPERATE A STORE MOST EFFICIENTLY

The exterior appearance of the store and the interior layout can make or break a retail business. The arrangement and layout, the displays of merchandise, the merchandise itself, the conduct and appearance of the staff, are all so closely related that it is a little difficult to consider any one element separately.

Together they mold an impression which is either good, ordinary, or bad. Here is a Department of Commerce check list of the characteristics that make for a good-appearing, smoothly flowing store operation:

Good sidewalks, easy entrance, and store floor at street level

Adequate illumination

Sufficient department identification to permit easy customer progress to the department sought

Sufficient aisle and circulation space to invite free movement about the store

Use of light, color, and space to create the impression of size and spaciousness

Easy point-to-point visibility throughout the store

Relating departments and goods to create maximum number of multiple sales

Placement of selected service and commodity stations to facilitate circulation and convenience

Accessibility of shelf and counter merchandise to invite self-service where desired. Eliminating excessive floor fixtures helps

More merchandise out in view, and less under showcases

Absence of most of the larger fixtures designed exclusively for goods of one manufacturer. Such goods may be consolidated with regular inventory in standard fixtures. (Sales volume and margin produced may justify exceptions)

Adequate ventilation to prevent unpleasant odors and to protect merchandise

Temperature in the store kept within the range of comfort

Adequate protection of goods against pilferage

Elimination of hazards to life, limb, or property of customers and employees

Maintenance of sanitary conditions

Absence of obsolete equipment, fixtures, decorations, displays, or non-

essentials that interfere with operations or take customers' attention from buying

Conformance to regulations governing sanitation, fire hazard, licenses, and other matters

Separation of service departments that are separable from selling (*a*) to avoid confusion and customer dissatisfaction, and (*b*) to facilitate the operation of individual departments

Limited use of uninteresting decorations, manufacturers' posters, window enamels, and decalcomanias

Expected customers' conveniences such as telephone and washrooms

Departmental arrangement calculated to promote the sale of high-margin commodities

Use of display that is best calculated to promote the department, the item, or the kind of business

Avoidance of unpleasant displays, or displays that may offend any important proportion of the patronage

Adjustability to expected peak loads

Conformance, in general, to habits of the people and the customs of the kind of business

Are you going to open a new store or another store?

The number of stores in the community will be a rough indication of the need for the store you want to open. The wholesalers in your line will help on that. They naturally have an intimate knowledge of the situation. They will know the type of goods sold and will have a pretty clear picture of how well the market is covered.

Wholesalers' representatives will also be aware of any old stores that are dying.

Let us suppose that all indications point to a need for another store. You will want first to think about *how much business you are likely to do* if you do open.

Remember that your store will have to share its sales volume with that of other well-established stores in the town. The question then is: *How much business do the existing outlets do?* Estimating the business done in various stores is not an easy matter. You can scarcely expect existing retailers to open their arms to new competition and give all the facts about their sales. Nor can you hope to come to any reasonable estimate unless you have had considerable experience in the field you want to enter. If, however, you have had a well-rounded background, you will be able (aided by wholesalers) to size up fairly well what you can get out of their volume—assuming you are going to have a store worth patronizing.

Chain stores sometimes use the following method of estimating the volume for a store location:

- Plot the nearby towns on a map, including those towns from which you might expect to draw trade. Draw a line around these towns. This will give you a fairly good picture of your trade area. It is within this area that you will be most likely to get the bulk of your business. It is in this area that you might calculate the number of families or the total number of people for arriving at an over-all sales potential
- List the names of competing stores in your town and in the other towns outlined in your trade area. This list should include all stores that carry lines similar to those you plan to handle
- Estimate the volume of sales for each of these stores
- Then guess how much of it good planning and good merchandising will take from them and give to you

In buying a going business, the problem is simplified. If experienced, you would expect to do about the same amount of business as the previous owner, and possibly more. Chapter 8 tells you how to go about a purchase.

How to choose the right town for your store

Regardless of your personal desires, you should be sure that you start your venture in a town which shows good possibilities of growing. In judging the future of communities try to classify them along the following lines:

- The growing town. Such a town probably grew rapidly during its early beginnings and then had a long-term gradual but steady increase in population and business activity. It may be that this type of town has not yet reached its full growth
- The town that has grown to its present level for sound economic reasons and has more or less maintained this same level over a long period, with little likelihood of a sharp decline occurring in the future
- The town that grew fairly rapidly and then leveled off over a long period, but which recently shows definite signs of losing population because of economic reasons. We might find in this class a number of towns and cities in the Midwestern dust bowl. In these localities there was a general migration away from the towns
- The declining town which may have had a quick start at its beginning, perhaps because of some special event such as discovery of gold or oil, or some other industrial activity that caused many people to rush to the town. Usually a mushroom growth developed, and then the economic justification of the town faded, causing a rather sharp decline in size with no apparent reason for the town's ever becoming important again unless by some occurrence which cannot be foreseen
- The small or medium-sized town which is in the road of something that may cause spectacular growth. An example of this type of town might be a small place where oil might be discovered some day, or where mining activities might develop. Ideal resort locations which have not yet struck a popular appeal may also be classified in this group

After you have narrowed your selection, tentatively, to a particular town, analyze it carefully. The more specific you can make your appraisal the better.

The following Department of Commerce list should bear on your decision. Other ideas will probably occur to you. But the details suggested will give a general picture of possibilities in a town. When you have completed your appraisal you can see whether the advantages outweigh the disadvantages.

Check list for guidance in selecting a town

Business factors (industry: farming-manufacturing-trading)
- *Trend of industry.* Highly satisfactory, growing, stationary, or declining?
- *Permanence of industry.* Old and well established, old and reviving, new and promising, or recent and uncertain?
- *Diversification of industry.* Many varied, many same, few varied, or entirely dependent on one major industry?
- *Stability of industry.* Constant, satisfactory, average, or subject to wide fluctuations?
- *Seasonal industry.* Little or no seasonal change, mild seasonal change, periodical (every few years) seasonal change, or extreme seasonal fluctuations?
- *Future of industry.* Promising, satisfactory, uncertain, or poor outlook?

Population
- *Trend of population.* Growing, large and stationary, small and stationary, or declining?
- *Wealth of population.* Wealthy, well to do, moderately well off, or poor?
- *Character of population.* Native born, mixed, chiefly foreign?
- *Mode of living.* Home owners, pay substantial rent, pay moderate rent, pay low rent?

Competition
- *Number of stores.* Few, average number, many, or too many?
- *Type of management.* Not progressive, average, above average, alert and aggressive?
- *Presence of chains.* No chains, a few chains, average number, many well-established chains?
- *Type of stores.* Unattractive, average, above average, or very attractive?
- *Nature of stocks.* Incomplete, average, above average, or complete?

Other facilities of the town
- *Transportation facilities.* Excellent, good, fair, poor?
- *Merchandise supplies.* Local, nearby, average distance, or long distance?
- *Banking facilities.* Excellent, good, adequate, poor?
- *Civic associations.* Aggressive, adequate, poor, or absent?

The town or community as a place to live
- *The following* are: Excellent, good, adequate, or poor?
  - *Schools*
  - *Churches*

Medical and dental services
Amusements
Climate

The people will be congenial, are your kind of people—rate excellent, good, fair, poor

You can hardly expect to appraise the town you are considering without a good deal of expert advice.

In fact, you will need to ask a great many questions of people who know the community. You will certainly want to visit the local chamber of commerce to get an idea of the future prospects and the current situation in the town. If any businessmen's group has been formed expressly for the purpose of working out plans for general business prosperity, be sure to visit it.

Talk also to experienced businessmen and a banker to get their views on general business conditions.

But no matter how bright the future of the community appears, unless there seems to be a need for another store, you would be foolish to consider it. You should feel reasonably certain that there is room for the store you are planning to open.

How to select the best store site

The matter of neighborhood or street location is simple if you decide to settle in a small town. Retail stores are usually situated in a compact area. Regardless of where you locate, however, you should know what to seek and what to avoid when making your selection.

Select a site where there is the necessary store traffic for your particular business.

It may be possible to attract business to an out-of-the-way, low-rent location. But it costs money to get people to leave a beaten path. It usually takes considerable advertising or low prices, or both. These may eat into your profits if they are carried on to an unreasonable degree. Use these guides:

There is a pretty direct relationship between location and rent; a good traffic location usually has a high rent, and an out-of-the-way location has a lower rent—but a high advertising cost

The balance of choice for a store seems to be in favor of the better location at a higher rent, provided it is within your means

With a good traffic passing the store, you can be assured that out of these passers-by, some will be attracted by your windows. Of those entering your store a certain percentage will buy. How large the percentage will be, is up to you

It is wise to locate near other retail stores and service establishments such

as drug, hardware, and grocery stores, restaurants, beauty shops, florists, and dry cleaners—where other businesses draw the kind of traffic that you need

Should you avoid setting up in business near aggressive competition?
Your store can be a success despite competition by capitalizing on the principles or methods of operation in which competitors are weak:
- Offering better merchandise assortments and selections
- Offering more adequate service
- Using more aggressive and intelligent sales promotion techniques
- Carrying either higher-priced quality goods or lower-priced lines
- Arranging better displays
- Stressing departments in which competitors are weak

Even though some communities may seem overcrowded with retail stores, there still may be an opportunity for a new establishment. A number of different kinds of stores clustered in a small shopping center adds to the location value of each store by drawing many customers to the locality

Pedestrian traffic is important. The chains spend thousands of dollars in studying store location.

One of the important parts of their studies is the counting of the number of people passing a given location. They also keep a careful check of the sex of passers-by, as well as of their estimated age and of other factors, such as whether they belong to low-, medium-, or high-income groups.

They carry on these tests over a considerable period of time and in all kinds of weather. They use their established outlets in similar locations to estimate the number of passers-by who enter a store and buy.

Conduct such a test, particularly if you are trying to decide on one of two or three sites. One way is by clocking each location for half-hour periods and at different hours during a number of days. You will get a fair idea as to which streets offer the heaviest traffic.

Experts advise selecting the location having the highest traffic count per half hour during the 1:00 P.M. to 5:00 P.M. period and on Saturday nights.

There is no general rule that always applies, except to choose the side of the street carrying the heaviest pedestrian traffic—the side that most customers prefer. If both sides attract an equal number of people, then you will be wise to choose that which is easier for automobile traffic to reach. And use these other guides:

Take the "going home" side in preference to the "going to work" side

Naturally a corner site commands a higher rent than does a site inside the block. Because it affords windows on two sides, it is particularly desirable for displaying a wide line of items, like that carried in a limited-price variety or general merchandise store. The decision as to a corner location, however, should be based on ability to pay the rent.

If the costs are excessive, you might much better be situated in the middle of a block

Locate in a thriving subcenter or neighborhood shopping section

Pick a shopping district made up of the usual convenience-type stores—drug, grocery, specialty, and hardware stores—and the typical service outlets. A recent trend has been the establishment, in outlying cities and nearby suburbs, of branches of big city departments stores. Thus a fairly complete shopping service is provided people living in these neighborhoods

A well-planned layout makes selling easier

A good layout ensures that counters, tables, shelves, and other fixtures are so arranged that customers can see the merchandise without hunting for it.

Putting merchandise out in the open, where customers have access to it, creates sales.

If a few items are stolen, the cost is generally far outweighed by the additional sales brought about by open display. No sales-minded merchant would keep other than extremely valuable items under lock and key. Of course, there should be supervision of the selling floor to prevent pilferage.

Use these principles:

Have the merchandise where the customer can see it. Of the thousand and one different things he might buy, the shopper can't remember more than a few specific things. The goods available in the store must be bought largely on impulse, and the impulse to buy them for home or personal use can be created only by the merchandise itself. This principle is supported by experience.

Have a well-planned layout that actively promotes sales of impulse goods. For instance, the chain variety stores always place their candy, jewelry, toiletries, and notions just inside the door, while to the rear are the underwear, housewares, etc. The reason is easily understood. A customer enters the store and goes to the rear to buy the things he or she needs, but coming in and going out he or she must pass the profit-making candy, jewelry, toiletries, and notions departments. And shown there are items which the customer had not intended to buy, but sees displayed and often buys on impulse.

See that fixtures permit the customer to see the merchandise as it actually is. If you want repeat trade, there should be no surprises or disappointments, because of poor store lighting, when purchases are examined critically later.

Induce people to go where you want them to go by using intensified, unusual lighting. In a test made by one store, nearly five times as many people as normally went to the back of the establishment were led there by increased lighting.

Call in a store layout man. His experience in layout, lighting, painting, and the multitude of things that go into a modern store can not only save money but ensure that your store arrangement is well planned. He can help plan counters that will be suitable for your merchandise and a counter arrangement that will save work in display and selling.

If no layout expert is available, get advice from your fixture supplier. Remember that a dealer is in business to sell counters and other fixtures. Therefore, the layout suggested may not be the most effective for the expense involved.

In the majority of stores, the greatest volume of profitable sales is produced by well-balanced departments. Space cannot be added to one department without reducing another proportionately. For this reason, do not tend to overdevelop one department at the expense of another, unless you are convinced that total store sales volume will be increased.

The following points should be considered when planning your departmental layout:

The amount of space to be given to a department is determined, to a great extent, by its location. Departments composed of a large percentage of bulky items and low unit sales are naturally forced to the rear of the store. Departments made up of small items with a high unit sale naturally come to the front. "Call" merchandise is displayed in the rear. Impulse items, whose sales depend upon display and suggestion, should usually be near the front

The physical requirements of the size and shape of the item may govern the location. So will the number of items in a department that can be displayed off the counter

Sales of competitive stores in the trading area govern location. It is necessary to obtain as much data as possible concerning competitive sales before determining the space to be allotted to a department

Advantages of a self-service store

Self-service stores reduce the labor in selling goods. They may take advantage of mass displays of merchandise as a sales-promotion device. Other advantages of self-service are—

Self-service sells more goods because of the open-display feature. This method enables the customer to examine the merchandise at leisure without the pressure of sales clerks. Open display suggests purchases that the customer may not have thought about or planned

Self-service usually results in a lower labor cost. This is an important consideration. Wages, principally of sales personnel, are usually about one-half of the total operating expenses of the retail store. The lower labor cost is possible because customers spend only their own time in

selecting goods. The fewer clerks needed can utilize their time more productively in actually completing sales

Self-service permits more goods to be sold during the peak rush hours. The clerks can devote their time to completing sales and wrapping merchandise

Sales clerks are necessary even in the more highly developed self-service operations: to assist customers in the selection of certain goods where a knowledge of the merchandise becomes important in completing the sale; where the question of size or fitting enters into the transaction

Self-service in the small store provides open displays of all merchandise for sale, utilizing tables and the larger counters for the horizontal merchandise. Special racks and stands have to be provided for apparel that is displayed hanging up. A service desk, equipped with a cash register and preferably with a clerk in attendance, is needed for completing the sale and wrapping the goods

In the smaller store having only one or two persons to serve customers, it is not feasible to have a clerk assigned to the service desk. Whoever is available at the time will have to watch for customers as they approach the service desk to have the sale completed

In relatively small stores it is not uncommon to see small cash registers conveniently arranged to serve the selling floor. Customers usually approach the cash register nearest them. As a precautionary measure, each cash register should be placed so that the clerk will have to slip in behind a counter to ring up the sale

Prevent damage to your store and injuries to customers and employees

The average store is not a dangerous place in which either to work or to shop.

But no matter how careful the storekeeper may be, there are times when the exercise of a little extra precaution will prevent damage to the store and injury to employees and customers.

Accidents, for the most part, can be avoided by using a few precautions. Here are some suggestions on reducing or eliminating hazards which may be present in your store:

Keep the store entrance clean:

Trash, refuse, slippery substances, or obstructions should not be permitted to collect at or around entrances and exits and immediately inside of building

Snow in front of the entrance should be removed as soon as possible, or sprinkled with ashes, sand, sawdust, or wood chips

In the event heavy rain forms deep puddles in front of the door, mop up the water to prevent its being tracked into the store, where it may make the flooring slick and dangerous

Keep the floor in good condition:

Flooring should never be allowed to become uneven or splintery (if wooden) or overwaxed or too highly polished (if tile, linoleum, or similar substance)

See that the floor does not become littered with trash or slippery substances

Control pests and vermin:

The structure containing the store should be so constructed as to exclude rats, vermin, and insects

It is vitally important to screen all doors, windows, and entrances

Traps should be provided for all sewer connections and covers for cellar drains

Keep the stairways well lighted and unobstructed:

Customers are not likely to venture down the cellar stairs or onto other stairways, but employees are, as this may fall within the line and scope of their employment. Stairways should be kept well lighted and completely free of mops, brooms, boxes, cartons, trash, and obstructions of any kind

Don't set up an "obstacle course":

Some stores have shown a tendency to display certain hard-to-get items in cartons and boxes scattered indiscriminately about the floor. This is done probably on the theory that the turnover will be so fast that it is hardly worth the effort to place the items on shelves or on gondolas

"Obstacle courses" are highly irritating to the customer who does not relish the idea of diving head first into a carton or box, or of running the risk of stumbling over it

Use common sense in stacking shelves and gondolas:

Do not overload shelves and display stands or carelessly stack cans and glass containers on them. Overloaded shelves may be disrupted and upset by customers, with resulting showers of cans and broken glass containers

It is an excellent idea to check shelves and gondolas for the presence of nails, tacks, rough edges, and splinters

Don't make a firetrap of your store:

Excelsior, boxes, rags, paper, inflammable liquids, and articles which may ignite from spontaneous combustion should never be permitted to accumulate where they may cause a fire, especially near heating equipment or in a storage room

If it becomes necessary to dispose of trash by burning, such burning should be done in an open metal container on bare ground

Have heating equipment inspected:

The majority of modern heating systems are provided with adequate safety devices, which are effective but will not operate indefinitely without attention

Frequent inspections are advisable for proper care and maintenance of all parts of the heating system

Heating appliances and equipment should be provided with proper insulation, including asbestos, magnesia covering, metal lath, and plaster

Planning a buying program for your store

Real buying skill comes only from practice. Even with experience, you cannot hope to do a perfect job every time you place an order. People's desires are too varied. Every individual buyer, or even group of buyers, is bound to make some mistakes.

The important thing is to keep errors down to a minimum. Recognize each one as it occurs, and make corrections.

Your buying will be governed to a large extent by what your customers need and want. Only by satisfying the consumer demand can you hope to move merchandise and make profits. Here are time-tested aids:

Guides to local preference are displays, both windows and interior, and advertisements of other stores. Get the advice of suppliers' salesmen. They will tell you of any marked likes and dislikes which may be caused by climate, average income, traits of nationality, etc.

A constant guide in buying wisely will be the requests of customers

A stock balanced between nationally advertised and private brands is recommended by merchandising experts

The advantage of nationally advertised brands is that the public is constantly reminded of their quality, durability, and general value. Thus a consumer demand is built for these goods, and they require comparatively little selling effort

Because of this intensive promotion on the part of the manufacturer, rapid turnover is ensured. As a result, national brands can usually be merchandised at a narrower margin of profit

With private brands, often a strong local demand is built up by a wholesaler

Sometimes the value is better than that of a comparable nationally advertised item

Sometimes it is possible to obtain exclusive local distribution of certain brands. Then the store is able to shave the margin of profit and offer the items at attractive prices. Low-profit leaders of this type are in keeping with sound merchandising principles

In buying the large assortment of items necessary, guard against too close a similarity in both goods and prices. That will slow customers' selections. If the price intervals are wider and the styles somewhat varied, the customer will be less confused. Salespeople will then spend far less time in explaining or justifying prices

How much should you buy?

Intelligent buying requires a thorough knowledge of terms offered by the seller. It also calls for a clear understanding of *how much to buy.* Use these guides:

See that your stock is never more than the amount necessary to handle your expected sales

Keep inventories low and cash high. That permits taking advantage of good deals—good opportunities

Think of your inventory as an investment. It must pay out—or be eliminated

Don't buy full lines—buy particular items you can move quickly

Avoid seasonal carry-overs if you can. Prices may drop

To maintain proper inventories and avoid late overbuying, peak stocks ahead of demand. Because of the various peak and slack periods in consumer buying, goods never flow evenly through a store

Work back from sales to purchase peaks. Successful retailers know when they can expect sales peaks. They schedule their buying far enough ahead so that they have the goods on hand

Compare not only price but terms. Take advantage of all cash discounts you possibly can. In many cases, it pays to borrow money in order to take discounts. The price of goods is really the net after all discounts

To compare quotations from different sources where terms vary, reduce them to a net basis, and add transportation. Net landed prices and not quoted prices should be compared. Goods from a nearby source at a high list may be a better buy than goods with a low list from a distant source, after delivery charges are added

Study carefully any offer to sell a large supply of goods at a substantial saving. The temptation to plunge is great. Overbuying of this sort at very tempting prices, in quantities far beyond the capacity of normal operation, is one of the first "don'ts" the retailer should learn.

Some of the other good buying practices are described here:

Advanced datings are sometimes granted by the seller to induce buying prior to actual needs. Goods may not be needed until just before the season opens. But manufacturers find it difficult to produce and ship to all buyers at the same time. This applies especially to seasonal goods. Sometimes the manufacturer will accept the retailer's order well in advance, ship the goods when they are ready, and send the invoice dated ahead. This date governs the beginning of the discount or net period for payment

Some manufacturers make a practice of selling on a consignment basis. This provides for payment after the sale. Sometimes regular payments are required (say each month). The advantage to consignment buying is that you do not have to invest your own money in the goods you purchase

Job lots, sample lines, and close-outs can be profitable. But be sure you analyze carefully the assortments and quality of the goods before you buy. These offers may be unbalanced as to sizes, contain off colors or out-of-date styles, or be so defective as to be unusable. The unsold portion of such job lots might easily contain all the profit on the purchase

Speculative buying is a form of gambling to be indulged in with only such money as is not required for the normal operation of a business. It is a dangerous risk for the average merchant with limited funds

A good buyer will risk reasonable purchases of untried items. Some of these prove highly profitable; others do not. Here again, experience, judgment, and sufficient money are of prime importance

Advance buying on a rising market is considered conservative merchandising for experienced merchants. When the market is rising, the retailer who buys in advance has two choices: he can mark up his goods on hand in accordance with the increasing market prices and make an additional profit. Or he can maintain his former prices based on a lower market and thus undersell competitors who are compelled to price with the rising market. The latter is preferred by the more progressive retailers. It gives the public the benefit of the lower prices

To buy intelligently, you must know how goods are packed as to quantities and assortments. Knowing this, you can avoid over- or underbuying. Goods are packed by the manufacturer for convenience in handling and shipping. Identical items may be packed in all sorts of cartons. Keep these points in mind:

Sometimes the manufacturer or the wholesaler will prepare well-balanced assortments that will sell out clean. Often, however, in assortments are end sizes and less desirable colors and styles

While the manufacturer's packing of an item is referred to in quantity units, you should always think of merchandise in units of time—a week's, a month's, or a season's supply. The stock of the safe-and-sure volume items on hand and on order should be gauged for a longer time than that maintained on the items needed for variety, to complete assortments, to build customer interest, or to increase markup

To help you keep well-balanced assortments, you should prepare your own guides. They will not only save time in preparing future orders, but will give you facts that can be learned no other way

Merchandise should be bought in quantities that can be sold within a reasonable length of time.

The danger of depreciation and obsolescence is greater, the longer goods are held. In addition, more time is required to take care of them, and more money must be spent for rent, heat, and light for storing or displaying them. As an example, assume the following expense ratios to sales:

Expense	*Ratio to sales*
Buying and selling (ordering, receiving, marking, selling, advertising, supplies, idle time)	0.09
Occupancy (rent, heat, light, preserving stock, markdowns, shrinkage)	0.09
Administration (unallocable expense)	0.05
Total	0.23

Let us suppose, further, that your average stock is a 3 months' supply. Occupancy expense above is 9 per cent for goods in stock for 3 months. That is equivalent to 3 per cent a month. Then the total expense chargeable to different items varies according to the length of time they are in stock, as follows:

Expense	Time in stock, months				
	1½	3	5	9	12
Buying and selling..	$0.09	$0.09	$0.09	$0.09	$0.09
Occupancy	0.04½	0.09	0.15	0.27	0.36
Administration	0.05	0.05	0.05	0.05	0.05
Total	$0.18½	$0.23	$0.29	$0.41	$0.50

The costs of holding merchandise in stock more than the average length of time, therefore, become more severe the longer a slow mover is kept in stock.

In buying larger than normal quantities to secure extra quantity discounts, the additional costs of carrying the goods on an "overtime" basis should be weighed against the quantity discounts. You would be wise to figure that an item carried in stock twice the average length of time is unprofitable at the average markup.

Aids in your buying program

Your sources include wholesalers, manufacturers, and various buying agencies.

The value of goods you get is determined by: the price you pay and the price you can charge; the service you get, such as speedy delivery, ability to buy a wide assortment in small lots, credit, and merchandising aids.

The *wholesaler's* main functions are: to buy direct from the manufacturer a large stock of assorted goods; to maintain a warehouse for their storage; to cover every town, large and small in his territory; and to provide prompt delivery service. He prospers only if his customers do. The progressive wholesaler puts as much effort into serving as he does into selling. Be sure that the wholesaler you choose fits this description. The major advantages to be gained through dealing with a first-class wholesaler are:

Some wholesalers have an efficient sales force made up of men who understand the retail business. They are well equipped to give practical advice and information on many phases of getting your business started. For instance, the salesman can suggest what merchandise you should stock. He knows the price ranges that will be the most profitable for your particular location and type of store. He is qualified to give good

advice as to how much money you should invest in inventory and in store fixtures and equipment, and as to whether you should sell on credit

Some of the larger wholesalers assist their retail customers in selecting a location. They may even supply, build, or help to choose the equipment. They also give suggestions as to financing, record keeping, and store operation

Your wholesaler can be of aid to tide you over credit problems. Remember that your credit rating will be a big factor in your relations with sources of supply during critical times, and to a lesser extent in good times. When goods are scarce, the choicest and most needed merchandise naturally goes to those retailers who pay promptly and buy the most

There are always bargains of one sort or another in the market. If you maintain close contact with your wholesaler, you will be informed when economical purchases can be made

Many wholesalers can give valuable help in meeting competition through advising on how to be a better merchandiser. For instance, he can give you sales aids such as displays, booklets, training courses for your salespeople, and ideas for promotion. Some wholesalers have departments to provide sales promotional, educational, and self-help material and guidance for their retail customers. With this help, many independent merchants are able to meet the toughest competition

Concentrating your own buying has the final advantage of permitting a close contact with your few sources of supply. You will have to see them often. They will follow your progress week by week. Thus they will be able to detect your weaknesses and help you strengthen them

Most *manufacturers* sell only one item or a group of closely related items. They can usually afford to send salesmen to serve only their large accounts. Sometimes they sell to smaller stores by catalogue.

Another source of buying is the *drop shipper.* He acts as a manufacturer's agent or broker. His function is to sell the merchandise but not to warehouse or handle it in any way, except in the credit and billing. The manufacturer ships directly to the retailer. The broker collects a commission, and handles billing and credit. Retailers using the services of drop shippers must buy a specified minimum quantity. Through serving a number of stores in their territory, brokers are able to provide a sales service attractive to some manufacturers. Drop shippers are favored by some retailers who want wide assortments from specified manufacturers.

Buying offices can help you

Buying offices or resident buying offices can serve the retailer in the principal market centers. The proprietor of a store who cannot afford to be constantly in the market himself often affiliates with a buying office. He may visit the market once or twice a year. His buyer keeps him in constant touch

with what is going on and what is available. The arrangement is especially important for style goods.

The services of a good buying office might be summarized as follows:

The buying office maintains a staff of buyers, each specializing in certain merchandise
It advises the retailer where and what to buy
It reduces mistakes of the retailer when he comes to market, because the available goods are reviewed by the buyers constantly, and they know what goods and which styles are selling
It saves the retailer time when he comes to market, because the buyers have lined up the best sources and best lines in advance. Through a buying office, a merchant can do in several days the work that would ordinarily require a couple of weeks
It actually buys merchandise on a general or specific request of the retailer
Some buying offices also extend to their clients advisory and bulletin services dealing with store operations. The principal ones are—
What goods to dispose of, and how to do it
Markdowns to take at certain times
How to operate on a turnover basis
Keeping stock in good condition and well balanced
Operating and stock-control methods
Personnel training advice for retail managers

The main types are the fee or paid membership office, the commission office, and the listing office.

The fee or paid membership office is operated as an individual business. A store may subscribe for a yearly fee that is usually based on the annual sales of the store. It is generally expected that the fee office must provide more service for the large store than for the small one. The fee office is hired by the retailer and receives no compensation from the manufacturer.

The commission office, on the other hand, does not charge the store a fee for buying. It charges the manufacturer a commission percentage for selling. The manufacturer pays this commission much in the same manner as he would pay his own salesmen.

The listing office is an important buying-service setup for some stores. It serves retail members who pay a uniform fee for the service and receives no compensation from the manufacturer. Here is how it works:

It furnishes a loose-leaf booklet or catalogue to members. Additional pages are provided weekly. On them are listed various types of merchandise with prices, sources of supply, and minimum order requirements. The merchant places his orders directly with the listed factories at the prices quoted in the service. The buying office supplies its own order blanks with the retailer's membership number stamped on the face of the forms
To secure the listings, buyers comb the markets for fast-selling merchan-

dise. Values and prices are sought that will enable the independent variety store to compete with the large chains

The lists of merchandise and sources of supply thus compiled are, naturally, beyond the capacity of any individual variety store to compile and keep up to date

The listing office may have its own wholesale house which keeps a stock of fast-moving staples and novelties for quick delivery

Usually the listing office, or other types of buying services, are used along with the services of the regular wholesaler. None of the various types of buying offices described will supplant the service of a regular wholesaler.

How to get good stock control for your store

Stock control is the retailer's method of maintaining a balanced inventory. It permits knowing at all times the quantity of each kind of merchandise on hand. It also shows (1) what to buy, (2) when to buy, and (3) how much to buy. Thus stock control and buying are each a part of the other. To be effective a stock-control system should—

Provide a guide which indicates what, when, and how much to buy by style, color, size, price, and brand

Reduce number of lost sales resulting from being out of stock on merchandise in popular demand

Locate slow-selling articles and keep track of them

Tell what goods to push for volume

Indicate change in customer preference, so that you can either decrease the weak items or eliminate them entirely from your stock

Indicate the need for store rearrangement

A stock-control system will not eliminate the need for judgment. But it does provide a reliable background of facts on which to base decisions.

There are many variations of stock-control systems. You may need to use more than one method if you handle many types of goods and buy from numerous sources. The plan used for year-round merchandise may differ in some respects from the control for seasonal articles. The size of your establishment and the number of people employed will also be determining factors.

Talk with your CPA about the method you should use. Should it be a control kept by means of observation? Or should it be by the use of "on-hand–on-order–sold" records, detachable ticket stubs, check lists, and a physical inventory?

As the name implies, the observation method consists of watching the physical layout of counter, shelf, and reserve stock. Generally a "want" book, in which items are recorded as needed, is used. While this plan

is obviously the simplest, it may often be the cause of losing sales. Merchandise may not be entered in the want book until stock on hand is almost or completely out. Without a better checking system, orders are usually placed only at the time of the salesman's regular visit. Unless you can develop skill and foresightedness in anticipating your needs, this method is not wholly satisfactory.

The on-hand–on-order–sold record is a plan which enables you to know how to order sizes, colors, or styles in proper proportion.

Detachable stubs on tickets placed on merchandise also afford a means of control. The stubs contain information identifying the articles to which they are attached. They are removed at the time the items are sold. The accumulated stubs may then be posted daily, or whenever desired, to a perpetual inventory. This analysis is particularly valuable as a guide to purchasing style goods.

A simple check list, often provided by wholesalers, is an effective means of controlling purchases. The list provides space to record the items carried and the selling price, cost price, and minimum quantity to be ordered for each. It also contains a column in which to note at checking time whether stock on hand is sufficient, or whether an additional supply should be ordered. Minimum stock, which can be entered, may have to be revised from time to time, as, for instance, if the general volume of your store decreases or increases. Often the check list is the main control. It has been developed in great detail by some wholesalers.

You must take a periodic physical inventory of your stock in order to prepare your profit-and-loss statement. This inventory involves counting the quantity on hand of each item in stock and determining its value. The total represents the value of the entire stock. The physical inventory should be taken at least once a year, although it may be taken more frequently. Strictly speaking, the physical inventory is not a means of controlling stock. But it can be used for that purpose, for when you are taking an inventory, you are actually handling each article in stock.

How to find if you have the correct stock for your store

To make any stock-control system work you must know the total stock on hand at the beginning of each month valued at the *selling price.*

Why use the selling price? Principally for the sake of consistency. Every activity of a store is based on sales. Goods are bought and expenses incurred in anticipation of future business. Sales are 100 per cent, and everything else is a part.

Current stock on hand, as well as sales, is then compared with the previous year's figure. Because of seasonal variation, stock is expressed as a ratio to sales of that year.

Then use these guides to find the proper stock:

The amount of present stock on hand is justified by anticipated sales. A ratio of beginning stock to sales for the period (month) represents the length of time (number of months) the goods would last if sales did not vary

This ratio may be compared with the previous year's ratio to find whether the stock is more or less in proportion to sales than it was a year ago

To find the rate of stock turnover, you divide the dollar amount of sales during a given period by the average of the beginning and ending inventories valued at retail prices for that period. The ratio may also be obtained by dividing cost of goods sold by the average of the beginning and ending inventories at cost

The turnover rate is governed by the nature of the goods, the source of supply, and the buying policy of the retailer. Perishable merchandise must be bought in small enough quantities so that it will be sold before spoiling. This forces rapid turnover

If articles are naturally fast sellers, it is easier to buy so the turnover will be high. Sometimes goods are packed in minimum shipping quantities, and when this minimum quantity is bought the turnover rate is automatically determined by the rapidity of sales

For proper control of seasonal and occasional merchandise you need to study—

An inventory of items carried over from previous similar event

A record of articles that sold out early, and an estimate of the additional amount of those articles that might have been sold

The age of unsold items. That helps you to detect slow sellers. It may assist in determining when to reorder or not to reorder. The simplest method to do this may be to list the month and year of purchase by code on each package

How to use budgets to control stock of a store

Regardless of how effective your stock-control system is, much of its value will be lost unless you do your buying on budget.

An estimate of potential of your sales force, the amount of your advertising, and the size of your sales is the basis of all future operating plans. It will determine your stock and will be valuable regardless of its accuracy. Having an estimate available for comparison with actual results will indicate any necessity for revision. You will also discover that your forecasting will improve as you go along. Your operation will be better because of your planning.

Develop your buying budget this way:

Since sales are the beginning of planning, it is natural that buying control

should be at selling prices. After the sales estimate is completed for a given period, it is a simple job to prepare the buying budget.

Your buying budget will be the sales figure, plus or minus any change you plan to make in your stock.

Usually the buying budget covers a 6-month period. It could as well be for 3 or 4 months. The main consideration should be the peak selling period. Refer to sales of the previous season in determining the items and quantities you intend to buy and the prices you expect to pay.

Make it your practice to order well ahead of demand. If you wait for the rush to develop you are likely to overbuy. And you may not receive the goods until the peak is past. As a result, you will be unable to estimate your needs for the next season because of the large carry-over. It, by the way, usually lasts until the middle of the next peak and again stimulates late ordering and overbuying. By ordering stocks in advance, you will have the goods you need for the mass displays in peak seasons.

How to price inventory for tax purposes

Cost, and cost or market, (whichever is lower) can be used for inventorying by a store.

But other methods are used by businessmen. For example, a popular method used by retailers is the retail basis whereby the retail value of inventory is reduced through adjustments for all markups and markdowns.

Two methods of finding cost which have common usage in business are the following:

Last-in–first-out—valuing the closing inventory by assuming that it covers first, at cost, the opening inventory to its extent. There are comparable quantities remaining in the closing inventory. Then value anything more in the entry at earliest cost to buy the quantity remaining

First-in–first-out—valuing the closing inventory by assuming that it covers, at cost, first, the most recently acquired stock at the cost of purchasing it. If there is any excess stock, value it at the next most recent purchase. Eventually you may have to value at prices used in the opening inventory—only if quantity of inventory on hand is less than quantity of purchases of a given stock during the year

There is an illustration showing the way the last two methods work in Chap. 11.

In valuing your inventory, you may not deduct a reserve for price changes or estimated depreciation in value. You must use its full fair value. You may not omit any stock on hand. But you can do this:

Value at estimated selling price, less the direct cost of disposition, the inventory which is unsalable at normal prices or unusable in the normal way because of damage, imperfections, shopwear, changes of style, old

or broken lots, outmoded fashions, or other similar causes, including secondhand goods taken in exchange

You may not take an arbitrary or blanket markdown from cost. But you can get a proper markdown of your inventory by showing that the goods are shopworn, or damaged, or outmoded because of style changes

Or you can show their true market value (bona fide selling price, less direct cost of disposition), and show that this market value is less than their cost

The *last-in–first-out method* is used a good deal by large stores. It assumes that the latest purchases are the first sold. That leaves the earlier purchases to be included in the closing inventory. Its use produces a higher cost of sales, and therefore it lowers income in periods of rising prices. The reverse is true if prices decline

The right to use the LIFO (last-in–first-out) method of inventorying for tax purposes is subject to this condition: it must also be the method of annual accounting reports to shareholders, partners, or other proprietors, or to beneficiaries for credit purposes. Here is how it works:

In a period of rising prices, your inventories will be below actual cost and also below the current market prices

Therefore, your profits will be lower using LIFO than if you use the ordinary methods

But in a period when prices are declining, profits will be higher when you use LIFO than when using inventories prices based on first-in–first-out

Over a long period, the result may be the same. But by using LIFO, you may be able to get lower taxes in a year when you desire them

When should you adopt this method of pricing? Do it when market prices are rising. If you do it when market prices are declining, you increase your income and increase your taxes.

How to price inventory for profitable sales

Retail merchants usually employ the "retail method" of pricing inventories. They can do this if: its use is shown upon the return; accurate accounts are kept; the method is consistently adhered to, unless a change is authorized by the government.

Under this method, the total of the retail selling prices of the goods on hand at the end of the year in each department, or of each class of goods, is reduced to approximate cost. This is done by an adjustment to cut the amounts previously added to the cost price for: selling and other expenses of doing business; margin of profit.

If you maintain more than one department in a store, or deal in classes of goods carrying different percentages of gross profit, you should *not* use a percentage of profit based upon an average of the *entire* business. The

government expects you to use the proper percentages for each *department* or *class* of goods.

Sometimes a company using the "retail method" adjusts the retail selling prices of the goods in the opening inventory and those purchased during the year for *markups* but not for markdowns. That practice is also approved. But adjustments must be consistent and uniform. Other rules to follow are these:

Where markdowns are not included, markups made to cancel or correct markdowns cannot be included. Markups included must be reduced by the markdowns made to cancel or correct those markups.

Markdowns which are not based on actual reduction of retail sales prices—for example, those based on depreciation and obsolescence—are never recognized.

If you have not determined inventories by following the practice of eliminating markdowns in making adjustments to retail selling prices, you may adopt the practice only by Treasury permission. But you always may do it in a first return of income, subject to approval by the Treasury upon its examination of the return.

The retail method of pricing requires that "accurate accounts" be kept. There must be consistency of method and proper handling of departmental profit percentages and of markups and markdowns. Regulations therefore require complete accounting orientation. This section and a good part of the law is couched in the language of the accountant. The effect is to force tax accounting to be in consonance with generally accepted accounting principles. *Hint:* Do not use this method unless you have good accounting advice.

How to price particular merchandise items

Profitable pricing of merchandise by the retailer is of the utmost importance. A high degree of skill is a requirement for survival.

In order to obtain the usual average markup, some items may have to carry more than average markups, and some lower than average.

Prices so low that they do not average out to cover costs, or so high that sales volume suffers, can quickly put a retailer out of business.

What governs markup? Some stores attempt to solve the pricing problem by merely following competition. Better sense says decisions on prices must be made on a more definite, day-by-day basis. Use these principles:

Markup is essential to cover your operating expenses. It must be large enough to do it

You buy to obtain value, but value is determined by what customers consider good. Their idea of value is relative. They compare your

prices with those of other stores. Customers will judge your markups as fair, or out of line, by those on the items that can be compared from store to store, such as brand goods

The greatest purchasing power for retail stores falls in the middle range of income. Therefore, in the nonluxury store, it is advisable to have a price level that will appeal to—

- The thrifty or value-conscious segment of the well-to-do class
- The large middle-income class
- The upper level of the low-income class

If the store is located in a high-income neighborhood it will probably do well to offer credit and delivery. You may assume that customers are willing to pay for these extra services

If the store is located in a medium-income neighborhood and offers no special services or types of goods to differentiate itself from its competitors, prices will probably have to adhere rather closely to the general level of competitors' prices

If the store is located in a low-income neighborhood where many customers require credit, and you provide credit service, you are justified in charging more than your cash-and-carry competitors

Distance from competitors is an important factor in determining the prices that can be charged. If you own a small store, for example, you would be foolish to attempt to compete on a price basis with a supermarket five or six blocks away. You will have to content yourself with the fill-in, pickup, and "off-hour" business. You may legitimately charge higher prices than competitors who do not render this type of service

In addition to the problems of location and competition, you must consider three factors: selling price, sales volume, and expense.

If you offer merchandise at a low price, you may get a large volume of sales. But you may not get sufficient revenue to cover the cost of selling the merchandise. On the other hand, if you have a high selling price, your volume of sales may be so low that you will be unable to meet your operating costs.

Clearly, the best prices are those which yield the most dollars after all costs are subtracted. This does not mean the highest possible markup on each unit or a price that will yield maximum sales. It means that prices should be fixed at the point where markup per unit multiplied by the number of units sold will yield the maximum gross margin over operating expenses.

The guiding principle should be that each item will cover its own extra costs plus whatever other contribution it can make to the general overhead and net profit. If demand for some items is small because competitors' prices are lower, an attempt to use the average markup would only make matters

worse. With the price for these items higher than that of competitors, sales will decline. As a result, there will be even fewer dollars of gross margin to contribute toward overhead expenses.

Only experience can teach you the feel of the market. If you are to succeed in making up for the things that you are forced to sell at low markups or even at cost, you must learn which items you can sell at higher markups.

For the most part, the average merchant limits his profit examination to a fairly simple routine.

Assume you are planning to sell men's shirts—white, plain colors, and fancies—at $1.98. Fancies do well, white is fair, plain colors are fair. You have been paying $15.25 a dozen for all the numbers. You could pay more; this cost is low for the selling price. You are satisfied with your fancy and plain volume, but think you should sell more white shirts.

Finally you decide that you will continue to pay $15.25 for fancies and plain but that you will promote white. So you pay $17.50 and get a noticeably better shirt, explain it to the salespeople, and promote it. The results will help to decide what to do next season.

Assume the cash discount equals the freight. During the previous season, 75 white shirts were sold. $15.25 a dozen is $1.27 each. $1.98 − $1.27 = $0.71 markup per shirt. 75 × $0.71 = $53.25. This season, 110 shirts were sold. $17.50 a dozen is $1.46 each. $1.98 − $1.46 = $0.52 markup per shirt. 110 × $0.52 = $57.20. Increased markup: $57.20 − $53.25 = $3.95.

You are neither much better nor much worse off than before. Probably some additional supplies were required to sell the 110 shirts, but help, overhead, and management costs were not increased. You might go back to $15.25 next season and try to cash in on the $17.50 reputation, or you might continue to pay $17.50.

One reason you might continue with the better shirt is because you think the increase will continue. Or, you might consider the effect of this individual item on the business in general. Increase the sale of any line in the store and all lines usually benefit. On the other hand, expense grows slowly—a little more paper and twine, a little extra help, but a lot more net. Here's about how it might work out:

Store volume	$22,500	Net 0.047 = $1,058
10 per cent increase	2,250	
Cost (0.700)	−1,575	
Additional gross profit	675	
Less: extra help and supplies, 0.050 × 2,250	113	
	562	

Increase in net ....562 ÷ 1,058 = 0.531, or 53.1 per cent

This calculation shows how a general store-wide gain in volume can build up net profit in much greater proportion than the sales increase.

When volume declines, however, expense cannot be cut in proportion and net profit shrinks much faster than sales. The stock is reduced slowly and the markdown ratio goes up.

There are certain special factors to consider in setting your prices:

Leaders and loss leaders. A leader is an article given a special price, usually below that charged by other merchants. The margin is less than normal. It is offered as a promotional item to increase store traffic. Leaders can be sold at a profit or at a loss. A loss leader, in its simplest terms, is one that is sold below its cost. It may be priced below its cost plus the estimated expenses involved in handling it. If the invoice cost of an item is 27 cents, the expenses are 9 cents, and it is sold for anything under 36 cents, it becomes a loss leader. A good leader sells itself. It should need no promotional effort. Items that are in everyday use, that are bought frequently, and that have a well-established value make good leaders.

Staples have a higher-than-average cost, because the markdown expectation is below the average. They are sold on value and price. Higher-price lines will cost less in proportion than the lower-price lines. The lower-price lines sell faster, are in the store a shorter time, and cost less to handle. Low-price lines should give value. People are more likely first to sample low-price lines. If these are found satisfactory, the same persons may later become steady users of both the popular and high-price lines. Staple volume depends on store traffic. Unless there is something distinctive about such merchandise, it does not benefit from promotion.

Novelties that catch on show a good markup at the start and as long as they continue to be popular. Soon, however, other manufacturers come into the field. The price is then reduced, and customers begin to look for new items. To cash in fully during the popular stage you must anticipate your needs. If you are overstocked on novelties in the initial period, before the price is reduced, your profits will be reduced by the necessary markdowns. If they sell out and must be reordered, the reorder may not arrive until after everyone has purchased elsewhere.

Extremely fashionable goods are in the same class as novelties. The fad may involve a color or a design. But its appeal depends on novelty. The markup is high. So are the markdowns at the end of the season.

Fast-selling items usually carry a lower-than-average markup. This is only fair. Their rapid turnover reduces the handling expense. It is important to have competitive prices on fast-selling items. Customers are familiar with their prices and values, and are critical of small price differences on fast-selling popular goods.

Slow-selling merchandise should carry a better-than-average markup. Customers generally are not critical of differences because they do not

have a well-defined idea of the prices and values. An item may become slow-selling, however, because the price is too high or the value is not competitive. This condition may be detected by comparing present with past sales, or by comparing with other stores. When you discover that an item is slow-selling, it is time to go shopping. See what your competitors are doing. Sometimes nothing can be done to improve the acceptance of an item. In such cases it is well to consider dropping it.

Prices fixed by manufacturers must be considered. Pricing sometimes is not left entirely to the discretion of the merchant. State and Federal laws governing retail selling should be checked with your supplier.

Simple formulas to find profitable markups

To understand the relation of costs, markup, selling prices, and gross margin it is necessary to restudy some retailing mathematics. You may not make constant use of the formulas and calculations which follow. But you should understand them. They are the ABC's in the language of the retailer. The terms to be dealt with are—

Cost of goods. Cost of goods is the landed cost at the store. It is expressed in dollars or as a percentage of sales. The cost divided by the selling price is the cost percentage. Thus, if an item costs \$1 and sells at \$1.50, the cost percentage would be $\frac{\$1.00}{\$1.50} = 67$ per cent.

Initial markup. Initial, or original, markup is what is added to the cost to get selling price, or the difference between cost price and selling price. It is expressed as both a percentage of sales and a percentage of cost. Thus, in the case of a \$1 cost and \$1.50 selling price, the initial markup would be 50 cents. That is 33⅓ per cent of selling price $\left(\frac{\$0.50}{\$1.50}\right)$, or 50 per cent of cost price $\left(\frac{\$0.50}{\$1.00}\right)$.

Retail reductions. Retail reductions cover all reductions of the original retail price, including markdowns and shrinkage. They are expressed as a percentage of final selling price or as a percentage of cost.

Additional markups. Occasionally it is discovered that an item has been priced too low in error. Or for some reason it is found desirable to raise the original price. Increases after the original markup has been taken are called additional markups. Downward revisions of the retail price are also common.

Markdowns. A markdown is a reduction of an original selling price. After a retail price is established on an item (by adding a markup to its cost), the price may have to be reduced for any one of a number of reasons, such as—

For special sales to stimulate volume
To clean out remnants, leftovers, poor assortments, and damaged goods
To get rid of poor buys

To meet sudden changes in the market price

Early markdowns are the smallest. The sooner you discover merchandise is not moving and start taking markdowns, the smaller your loss will be. The time to sell is when people want to buy and not at the end of the season after everyone has bought. When you start to mark down, it is best to forget all about cost and continue marking down until the goods are sold.

Gross margin. Gross margin, sometimes called realized margin, gross profit, or maintained markup, means the amount realized after all retail reductions—the difference between the final selling price and the cost of goods. It is expressed in dollar amounts and also as a percentage of sales.

It is easy to determine the *selling price* from the cost if you know the cost, or markup, ratio you wish to achieve. The formula is

$$\text{Cost} \div \text{cost ratio} = \text{selling price}$$

Work from the cost ratio, as it is simpler and less confusing, and your known figures correspond. You start with a cost price and get the selling price of a given cost ratio; for example:

Assume that the item cost \$0.72 and the cost ratio desired is 0.67.

$$\frac{\$0.72}{\$0.67} = \$1.07 \text{ selling price}$$

Also, the appropriate cost may be determined for any selling price by multiplying the selling price by the cost ratio; for example:

Assume that the selling price is \$0.98 and the cost ratio desired is 0.67.

$$\$0.98 \times 0.67 = \$0.66 \text{ cost price}$$

This same method may be applied to reduce the markdown ratio to cost in order to determine its net effect on profit, for profits are reduced by the amount of the cost of the markdowns.

The average markup for the store is composed of numerous rates of markup for the different goods handled.

Some goods will have to be sold at a close margin, either because they are competing in price with merchandise in other stores, or because they are used as leaders to bring in trade. Other items will be sold at or about the average markup sought. Still other articles will carry a long profit markup. Then there will also be variations in relative sales of the goods at different markup rates.

A little arithmetic will show how to arrive at the average total store markup under such conditions.

Let us assume for simplicity that there are three items, or three departments, with sales and markups as follows:

Department	*Sales*	*Maintained markup, per cent*
A.	$20,000	20
B.	10,000	25
C.	5,000	35
Total	$35,000	

The gross margins then would be:

A.	$ 4,000
B.	2,500
C.	1,750
Total gross margin	$ 8,250

$$\frac{\$8,250}{35,000} = 23.6 \text{ per cent}$$

If the average maintained markup is not sufficient to allow for a net profit after expenses are deducted, then the sales volume must be increased to lower the expense percentage, expenses must be reduced, or some revisions in the lines must be made so that more goods are sold at a higher markup. Margins cannot usually be increased by arbitrarily raising selling prices.

The next problem is to calculate an initial markup to establish original retail prices, making due allowance for markdowns and shrinkage which are known as retail reductions. For if goods are priced at the outset at the markup which is desired as a final maintained figure, and if markdowns or shrinkage later occur, you may find that the realized margin is far below the total you had planned to cover expenses and profit.

The retail reductions will apply more to some lines than to others. Some staple lines in steady demand, with little or no spoilage, breakage, or theft, and on which no cut-price sales are made, will be no problem. The initial markup on such goods may be counted on as a maintained markup.

But on merchandise having a style or use obsolescence on which markdowns must be anticipated, or on goods subject to deterioration, pilferage, or other shrinkage, the initial markup will have to be higher than the planned, maintained, or realized markup.

At the start you will have to make some rather arbitrary allowances for such anticipated retail reductions. As you gain experience, you will know more precisely what goods will be subject to the reductions, and how much the reductions will usually amount to.

One object of good merchandising is to reduce markdowns to a bare minimum. This goal involves improvement in practically all phases of the store's operations, but principally in buying, selling, stock care, and pricing.

The table on page 193 will serve as a guide to show what the initial markup should be in order to end up with a stated gross profit. This makes allow-

ances for different rates of estimated retail reductions. The formula for calculating at any gross profit or any retail reduction is this:

Per cent initial markup on selling price =

$$\frac{\text{per cent gross profit desired} + \text{per cent retail reduction to sales}}{1.00 + \text{per cent of reductions to sales}}$$

Example: Per cent gross profit desired = 40
Per cent retail reductions to sales = 5
Find markup required as a percent of sales

$$\frac{0.40 + 0.05}{1.05} = \frac{0.45}{1.05} = 0.4286, \text{ or } 42.86 \text{ per cent of sales}$$

If a markup of about 43 per cent of sales is required, the per cent to add to cost price would be approximately 75. Thus,

$$100 - 43 = 57 \text{ (cost)}$$
$$\frac{43}{57} = 75 \text{ per cent}$$

Initial Markup to Produce Specified Gross Profit, Allowing for Stated Retail Reductions

Gross profit to be realized, per cent	Retail merchandise reductions, per cent of to net sales					
	5	6	7	8	9	10
	Gross markup required, per cent					
25	28.57	29.25	29.91	30.56	31.19	31.82
26	29.52	30.19	30.84	31.48	32.11	32.73
27	30.48	31.13	31.78	32.41	33.03	33.64
28	31.43	32.08	32.71	33.33	33.94	34.55
29	32.38	33.02	33.64	34.26	34.86	35.45
30	33.33	33.96	34.58	35.19	35.78	36.36
31	34.29	34.91	35.51	36.11	36.70	37.27
32	35.24	35.85	36.45	37.04	37.61	38.18
33	36.19	36.79	37.38	37.96	38.53	39.09
34	37.14	37.74	38.32	38.89	39.45	40.00
35	38.10	38.68	39.25	39.81	40.37	40.91
36	39.05	39.62	40.19	40.74	41.28	41.82
37	40.00	40.57	41.12	41.67	42.20	42.73
38	40.95	41.51	42.06	42.59	43.12	43.64
39	41.90	42.45	42.99	43.52	44.04	44.55
40	42.86	43.40	43.93	44.44	44.95	45.45
41	43.81	44.34	44.86	45.37	45.87	46.36
42	44.76	45.28	45.79	46.30	46.79	47.27
43	45.71	46.23	46.73	47.22	47.71	48.18
44	46.66	47.17	47.66	48.15	48.62	49.09
45	47.62	48.11	48.60	49.07	49.54	50.00

Many goods are bought to sell at a designated retail price, in accordance with competition and with your analysis of what price lines will sell best. In buying goods to advantage so that you can sell at the desired prices, the initial markup is automatically set by the cost price.

Suppose you want to carry a \$1.95 line of men's dress shirts, and that the quality you want will cost \$17.40 a dozen, or \$1.45 each. The initial markup is set at \$1.95 less \$1.45, or \$0.50. Thus, the initial markup would automatically be 25.6 per cent of sales. Excessive retail reductions would bring the realized margin dangerously low.

If allowance must be made for markdowns and shrinkage, two questions arise:

At a given initial markup and an estimated shrinkage, as a per cent of sales, what will the realized gross margin be?

In order to realize a planned gross margin with a given initial markup, how much can be allowed for retail reductions?

The calculation for the first situation is as follows: Cost of goods $\times$ retail reductions per cent = reductions at cost. Initial markup − reductions at cost = maintained or realized markup.

Example: Per cent initial markup = 40
Per cent retail reductions = 5
Find the maintained markup

$$1.00 - 0.40 = 0.60 \text{ (cost of goods)}$$
$$0.60 \times 0.05 = 0.03 \text{ (reductions at cost)}$$
$$0.40 - 0.03 = 0.37 \text{ (maintained markup)}$$

Suppose, in the case of \$1.95 shirts, that you estimate the retail reductions would be 5 per cent. What would the realized margin then be? The calculation follows:

$1.00 - 0.256 = 0.744$ cost of goods
$0.744 \times 0.05 = 0.0372$, or 3.72 per cent reductions at cost
$0.256 - 0.037 = 0.219$, or 21.9 per cent maintained markup, or gross margin

If the 21.9 per cent gross profit is lower than you want to take, just what retail reductions may be taken to leave you the minimum realized margin, (say 23 per cent)?

The calculation to arrive at this answer follows: Initial markup per cent − percentage of gross margin desired = per cent of reductions at cost; reductions at cost ÷ cost of goods = per cent reductions allowable at retail. For example:

$$0.40 - 0.37 = 0.03$$
$$\frac{0.03}{0.60} = 0.05, \text{ or 5 per cent allowable retail reductions}$$

Let us apply this calculation to the $1.95 shirts where the initial markup is set. You want to know just how heavy a retail reduction they will stand to give you a final stipulated gross profit, in this case 23 per cent. You know that the initial markup will be 25.6 per cent of sales, and you know the desired gross margin. Let us see in this practical example how far you can go in markdowns and shrinkage reductions.

$$25.6 - 23.0 = 2.6$$

$$\frac{2.6}{\underset{(100-25.6)}{74.4}} = 0.0349, \text{ or } 3.49 \text{ per cent retail reductions}$$

You know that at the cost and selling price of these shirts, you can afford to take retail reductions of only 3.49 per cent if you want to realize at least 23 per cent gross profit.

How to keep your salespeople constantly alert

Training is a continuing function. Emphasis needs to be placed on the training of new, inexperienced salespeople. That is, it is desirable to establish correct selling habits from the start. That is covered next in this chapter.

Training must not stop with new salespeople. To be most effective, it must be a continuing process. Older, experienced salespeople must be kept on their toes. They must be given new merchandise information. They cannot be allowed to slip into the habit of serving your customers indifferently.

To do that effectively, you will need to keep fully informed about new developments in your line of business. Your business paper and the salesmen who call on you can provide much new information about trends, merchandise, and merchandising methods.

The kind of information needed by the salesperson depends on the types of merchandise the store carries. In general, the salesman's knowledge of his goods should embrace the points given in the following check list. Some of the points, of course, will not apply to every product.

- The product's uses
- Company making it
- What it is made of (composition)
- How it is made (construction)
- Type of finish and style
- How it will perform
- How it is operated
- How to care for it
- Services available with the product, if any
- Its competitive features

Some salespeople will obtain much-needed merchandise information on their own initiative, provided you give them the right kind of encouragement. For example, the curious-minded will read, without prompting, the labels

and instructions on the merchandise itself, if they know the time taken up is considered in the store's interest. Others will have to be told to read such merchandise information, so that they can pass it on to customers. How can you help to enable salespeople to get additional guidance and information?

You might set aside one place in the store for catalogues, circulars, business papers, and even books appropriate to your type of merchandise. Keep these materials up to date and encourage their use. Generally, information about the merchandise may be obtained from—

- The labels, tags, and packages themselves
- Manufacturers' merchandise folders and catalogues
- Books (public library)
- General magazine advertisements
- Factory and wholesale house salesmen
- Customers and users
- Store buyer or other employees
- Competitors' stores and windows

It may be desirable to hold regular sales training meetings with your employees. Meetings may be devoted to presenting and demonstrating new or unusual merchandise about which salespeople need product information. These demonstrations may be given by salesmen from the factory or wholesale house, by you, or by one of your better qualified salespeople. Store and customer relations problems also can be discussed and ironed out at such meetings. Every employee should be urged to take an active part in the discussion.

If your salespeople show an interest in taking part in a regular, organized training program in retailing and selling, it may be possible to arrange a part-time or evening-class course. If such courses are not now offered in your community, the local superintendent of schools might arrange for their initiation.

How to train new salespeople

We have just talked of striving for better customer relations by all employees.

Success or failure in developing and maintaining good customer relations is largely in the hands of salespeople. Since this is true, the retailer must take every precaution to train new employees to treat his customers with the courtesy and thoughtfulness to which invited guests are entitled. He needs an effective training program, designed to meet the needs of his store.

How do you start the plan of training with new salespeople in a store? The most important time in the training of a new salesperson is the first day. On that day he is full of ambition and enthusiasm. He wants to learn how to do his job. Do this for him:

Take advantage of this interest. Tell him about the early history of the business, about your experiences and successes, about your plans for the future

See that he gets acquainted with the other employees

Encourage him to become generally familiar with the merchandise in the store while he is becoming acquainted with the general operations in the store

Take as much time as is necessary to explain the policies that set the pattern for the store's relations with customers, employees, and other business concerns and organizations. This will include policies relating to the types of merchandise, quality, and price lines carried; advertising and promotion methods used; customer services provided, including correction of store errors and adjustment of complaints; employee regulations; salary and leave policies; and general business practices

Explain how he can do a better job if he knows your policies

Encourage him to ask questions. Then question him to be sure that he understands the policies so well that he can represent you in his dealings with the customers

If you have a written statement of your store policies and regulations, this is a good time to give your new employee a copy so he can study it

After introducing a new employee to the store and telling him about your policies, you should next start training him in the details of his job. For convenience, the selling job may be divided into two parts: first, the mechanics of handling the transaction, and second, serving the customer. For training purposes, it is best to teach these operations separately. The inexperienced salesperson will find it easier to grasp the entire operation if it is first explained and demonstrated in full.

Delegate actual training to one of your more experienced salespeople—one with the patience and understanding to instruct without destroying enthusiasm. Move this way:

Training in the mechanics of the transaction should include writing up sales slips, wrapping packages, using the cash register, and counting change back to the customer in the prescribed manner. Get the new employee to practice them until he does them with ease

Teach him how to approach and greet the customer, determine his needs, show the merchandise and stress its selling points, meet objections, close the sale, and interest the customer in related merchandise

Show him your own selling techniques—those you have found particularly effective in your store

Get the new employee to follow these rules:

In approaching and greeting a customer:

Approach the customer promptly and courteously

Welcome him with a pleasant greeting. Address customers by their names

whenever possible. Try to remember their names, even though they do not buy from you frequently

Show a friendly interest and a sincere desire to be of service

If the customer is already examining merchandise when approached, make some comment about it, such as, "This is one of our new models." It provides a good opening

Next, make an alert and pleasant inquiry, to lead the customer to indicate his interest in that or related merchandise

Serve customers in turn, unless those entitled to first service agree to let a late-comer who is in a hurry be served ahead of them

In determining the customer's needs:

Ask a few well-phrased questions to lead the customer to explain his needs

Pay close attention to the customer's reactions and comments about the first merchandise shown

Eliminate as quickly as possible any items which clearly do not suit his needs

Concentrate on those which appear to meet his requirements

In the presentation and demonstration:

Display the merchandise to its best advantage

Analyze the chief selling points in terms of the customer's needs

Demonstrate the uses of the item—get the customer to examine or handle it

Show him how to use and care for it

If the article is something that can be tried on, suggest that the customer do so, and be honest in expressing an opinion if one is asked

In meeting objections:

Answer objections fairly and completely

Describe compensating features such as quality, manufacturer's reputation, economy, and special uses

Never argue with a customer

If possible, avoid mentioning competitors' goods

In closing the sale:

Close the sale promptly but without appearing in a hurry

Do not overtalk

Do everything possible to close the sale to the mutual satisfaction of the customer and the store

Even if the customer does not buy, encourage him by your attitude to come in again

Avoid high pressure—customers like to "buy"; they are not likely to return if they feel they have been "sold"

Suggestion selling:

After the sale is assured, suggest additional items which might also serve the customer's needs. The merchandise best suited to suggestion selling is that which is seasonable and appropriate, near at hand, related to the goods purchased, and attractively displayed, and about which the customer does not have to deliberate long

After the sale:

All promises as to deliveries, gift wrapping, trial use, service, and other store policies should be carried out to the letter

The sale is successfully completed only when the customer is satisfied with his purchase and when he recalls the store favorably as a desirable place in which to trade

To accomplish this, it is essential that the purchased item meet the need of the customer and that he realize, from the way in which he has been served, that his patronage is appreciated

How to get the greatest benefit from your window display

The purpose of your window display is to attract the attention of passers-by and make them want to come in and examine your stocks.

Too often the windows are unimaginative and dull. They fail to do an effective selling job. Sometimes the display is a conglomerate mass of different designs. It looks as if the dealer had tried to exhibit his entire stock.

A recent poll revealed that 93 per cent of the customers interviewed had "window shopped" before they bought. Furthermore, 55 per cent of the purchasers had had no previous intention of buying. They did so only after they had seen the merchandise displayed.

The average shopper's opinion of a store's merchandise, quality, price, and style is largely formed on the strength of its window displays. Arranging attractive "selling" displays is a challenge to any dealer. The money expenditure need not be great. Added sales will repay you in a short time. Look carefully at your window display and see if you think it will sell your product. If not, you'd better do something about it. Use these aids:

Effective use of color is your best means of attracting the attention of passers-by. But be sure the colors don't clash. They need not be bright colors. An atmosphere of quiet and tasteful simplicity often draws as much favorable comment as a brilliantly dramatic display

Proper lighting also is important. There must be no glare or shadow cast on the goods displayed and no light shining on the eyes of the person examining the window. Fluorescent lighting comes nearer giving an appearance of daylight. Spotlighting can be used to advantage too, especially to call attention to the display at night

If the display space inside your store is rather small, you will want to emphasize your window displays even more strongly. With wall panels you can set up a room display. Paper the panels as if they were actually the walls of a room

Other merchants in the town will probably be glad to lend you suitable pieces of furniture, pictures, draperies, and other accessories, in return for your placing a card in the window reading: "Furniture and accessories courtesy of the ——— stores"

Window displays must be changed often. Wallpaper display can point up seasons and holidays

Whatever kind of window you use, remember that the display featured there should arouse interest in the goods and create a desire for them. Better still, it should entice prospective customers into your store. There you will have a chance to find out what they want and to supply their needs

How advertising can help you meet competition

For any store, large or small, the most pressing problem today is the growing competition.

One of the ways to meet this is through advertising. Often the merchant cannot spend large sums on advertising. But, by careful planning and wise use of advertising best suited his needs, he still can achieve good results with a small outlay.

Skillful advertising can be profitable in several ways. The most immediate and most direct benefit can be an increase in sales, both of advertised items and of additional items bought by the shoppers who are attracted to his store. Advertising can also bring him these gains (not so apparent because they are built up over a period of time):

Every store depends upon certain characteristics, such as convenience of location, to attract and hold customers. The advantages of a store which have strongest appeal provide a foundation upon which all the advertisements should be built. By using the same fundamental appeal in all his advertising the merchant can give his store an identity of its own. It sets it apart from other stores.

Customers will come to associate the store in their minds with friendly, courteous service, quality items, or whatever characteristics and customer advantages are stressed in the advertising. The advertisements thus will do more than an immediate selling job. They will collectively build up public recognition, confidence, and goodwill for the store.

Don't try to do the job yourself. See if you can find an advertising agency delighted to work with you. They are intensive students of retailers' problems. And they will be of enormous aid in cost cutting.

Have a fixed advertising allowance. The amount to spend on advertising during the year should be determined carefully in advance as a definite percentage of net sales.

The appropriation should be based on either net sales for the previous year or on the sales you hope to achieve during the next year.

Manufacturers, wholesalers, and newspapers may help plan more attractive advertisements. They often provide excellent cuts, mats, and suggested copy

slants. This expertly planned material generally will be furnished without charge. Make full use of it, for it will help to keep your advertisements up to date, appealing, and effective.

Consistent advertising brings best results. Experience has shown that advertising brings best results when used consistently. For this reason, the merchant will do well to spread his advertising over the entire year, instead of devoting his full appropriation to a few expensive advertisements for special occasions.

Use smaller, less expensive advertisements at frequent or regularly scheduled intervals, to keep your store and its merchandise and services regularly before the public.

The methods open to advertisers are by direct mail, local newspapers or shopping papers, and spot radio announcements. The audience possibilities of each might be broken up this way:

Newspapers and shopping papers—publishers will furnish circulation statements

Direct mail—quantity is determined by you; recipients can be individually selected

Spot radio announcements—audiences primarily determined by what precedes, what follows, and audience available at the time

What about the cost per unit of coverage for each method?

Newspapers and shopping papers—fixed by publishers' rate cards; cost per 1,000 copies known in advance; percentage of useful circulation governed by character of product or service advertised

Direct mail—cost per mailing piece is determined by you, but usually it is higher per 1,000 than other media

Spot radio announcements—cost per listener can be estimated through audience ratings of programs before and after the announcement

All three methods can be timed to meet your sales needs, both as to dating and as to frequency.

If illustrations are important to selling effort, direct mail offers almost unlimited possibilities. It gives you any size and treatment, within limits of format selected and reproduction process employed. With newspapers, the size is limited by insertion dimensions. Reproduction is through line cuts and coarse-screen halftones. Radio programs offer no pictorial appeal, but dramatized commercials may give strong impressions.

Consider the factor of competition for attention. Direct mail is opened and recipient's interest is aroused. It gets undivided attention. In newspapers, you are affected by the position in the paper and on the page; the size of insertion in relation to surroundings; the interest of adjacent editorial matter and advertisements; the effectiveness of layout and display.

Radio programs hold a listener to only one broadcast at a time; a popular program can build a continuing audience. Almost complete attention is given to the commercial.

What about the useful life of the message?

Direct mail—can be preserved for reference by interested recipient
Newspapers—little holdover value; ordinarily a paper is discarded within a few hours or one day after publication
Spot radio announcements—auditory suggestions are more effective than visual but no holdover except through repeated impression

Newspaper advertising and shopping papers are particularly suitable for use by stores in smaller and middle-sized communities. They can be employed to good advantage, also, by stores which are located in downtown shopping areas of large cities.

Although neighborhood stores in large cities generally find advertisements in daily newspapers too costly, they sometimes advertise in neighborhood and shopping newspapers. Or they join with stores of other sections to run cooperative advertising in daily papers.

Here is what experts tell you to do in copy preparation for newspaper advertisements:

Make the advertisements distinctive—so distinctive that customers will *recognize them immediately.* Some tested ways to do this are by using: uniformly sized advertisements; the same distinctive borders and type face in each advertisement; a slogan tied in with an attractive store characteristic (for example, "The Store of Quality Foods"); a boxed editorial or recipe in each advertisement.

Schedule the advertisements. Advertising gains in effectiveness when used frequently and on regular schedule. Small advertisements appearing at regular intervals generally are more productive for the merchant than occasional large ones.

Choose items to advertise. Offer customers the items that they want at the time that they want them. This means choosing: items that are timely because of seasons, holidays, local events, and national advertising of manufacturers and producers; items that have wide local appeal; items that are frequently purchased. Another factor is variety. Inclusion of varied items in advertising broadens its appeal.

Plan a good selling advertisement. It must attract attention, arouse and maintain interest, create desire, and induce action.

Some effective attention getters or "stoppers" that one can use are pictures of people, cartoons, recipes, pictures of attractive food items, serving suggestions. Use headlines that appeal to the emotions of the housewife, such as one that tells her "How to Be a Better Cook" or "How to Improve Your Cooking."

Interest in an advertisement can be maintained by making it generally at-

tractive. Good ways to do this are by leaving ample white space in the advertisement so that it does not appear crowded; by varying type sizes to avoid a monotonous effect; and by using good illustrations freely.

Use tempting pictures or word pictures of them. Effective word pictures of items can be built with such descriptive words as "creamy," "garden-fresh," "highly seasoned," and "flavorful."

Lead the housewife to desire items and spur her to buying action. Induce her to buy by giving her, in a few words, a reason for buying each item, and by featuring daily specials, limited time offers, and quantity pricing.

Be careful in wording the copy. Write briefly; use simple words; never exaggerate. Be truthful at all times. Whenever possible, give facts about the items, not just opinions. Write cheerfully and positively.

Using outside salesmen may help you

Some kinds of stores find it profitable to have outside salesmen. The job of instructing them is the same as that with inside people. But cost control is more important.

Sales outside the store create a lot of special problems. You need to study your costs in the same way that wholesalers and small plants do (see Chap. 11); for example—

Are you taking too many small orders or taking less than minimum quantity orders or giving undeserved "courtesy" discounts?

Your whole sales plan should cut out costly practices; for example—
- Needlessly long credit terms
- Premiums
- Overgenerous return privileges
- Excessive guarantee
- Unreasonable deliveries
- Concessions on freight and delivery charges
- Unrestricted service after the sale

Control requires that you find out what each customer should be buying. Then see what the salesmen should do about it. Know when and how often the salesman should call on him.

If an account proves unprofitable after a fair trial, take it off the salesman's call route, perhaps then soliciting by correspondence only. Watch this problem particularly in connection with accounts which are "off route" and therefore expensive to cover. Here are a lot of other checking points to eliminate waste:

If your product is sold through dealers, study the mechanics (see Chap. 12) adopted by wholesalers

Coach your salesmen to suggest practical sources of new income

See if they can help with dealer operating economies, upkeep and repair service, new lines, etc.

Have all salesmen report to you suggestive examples they observe

Give that information to your other salesmen

Don't ship out sales literature and samples indiscriminately, at a salesman's request

Keep the amount in proportion to dealer's or jobber's volume

Make exceptions only when a salesman has secured a definite commitment for a special drive

Find out whether your catalogue, if a large one, can be reproduced in smaller size or a less expensive process

See if a smaller edition can be given by your salesmen

If your goods are sold through retailers, show your salesmen how to

Spot new, untrained salespeople

Teach them how to sell your merchandise

If selling to industrial customers

Be sure salesmen do not take it for granted that buyers will know how to use your product to best advantage

A complete educational job may be necessary with each new customer

Use instruction sheets and wall charts, for distribution to customers and to established users with factory forces. Give them: detailed guidance, starting with the ABC's of how to get maximum service from your product; similar instructions about its protection and maintenance

Point out to your salesmen that some of their customers and prospects may have the necessary equipment to complete articles delivered to them in "semifinished" form and urge them to keep watch for such opportunities to increase your output of merchandise

Watch salesmen's costs and the way salesmen work (Read Chap. 11.) This list of trouble spots may help:

Concentrate on preferred accounts and nearby territories

Abandon quickly personal sales work in territories not paying their way or near the danger line

Schedule all efforts so as to get most economical selling

Eliminate overlapping and backtracking in routing

Lay out territories for minimum travel costs for desired coverage—stop routing by past habits or salesmen's preferences

Eliminate "jumping" from edge to edge of territory to cover an inquiry without the precaution of telephoning to ascertain if the call is really urgent

Hold the reins tight on restless salesmen who prefer to move on rather than "mop up" where they are

Stress the importance of making sure that the prospect or customer will be on hand when he calls

Urge the use of advance cards, telegraph, and telephone to make specific appointments for interviews

Coach salesmen, when making missionary calls with dealer or jobber salesman, to arrange that the local man furnish the transportation

Consider rescheduling your salesmen so the greater part of their time is spent on "cream-skimming" trips by plane and train, covering easily reached customers and prospects, with only occasional automobile trips for intensive coverage

Get a veteran salesman to recall how business was cultivated before the day of the automobile. Some devices may be suitable for revival

Showing lines in sample rooms

Fewer week ends at home

Fewer concessions in connection with size of order

Fixed minimums for acceptable orders

More use of shoe leather

If salesmen's samples are bulky, problems arise without an automobile. Consider having them carry photographs instead of actual samples

Have the pictures actual size if possible

If not, make them as large as can be conveniently carried

Make them clear and descriptive

Use color if that is desirable

What are some danger signs to consider as you change your salesmen's activities? Consider whether it is time to drop those salesmen who have proved disappointing. Or study a change in sales territories to realign with recent population and income shifts

Think a long time before you curtail or drop your sales force in favor of side-line men. They are less amenable to control. They will tend to do a sales job on a short-haul basis. They give preference in allotting their time to their accustomed lines

Move slowly in trying "combination traveling" with noncompetitive salesmen. It's cheaper but slower. Your men will be less available in an emergency

On the other hand, be open-minded toward "sales caravans" in which a number of noncompetitive companies participate. Prospects are attracted into central points at which the caravan stops and displays its samples

Is your procedure in maintaining contact with salesmen a heavy, though hidden, burden on selling costs, using up income that otherwise could be used to build stronger selling? Close supervision should be maintained on such questions as:

Could smaller or cheaper letterheads be used for most letters?

Are carbon copies being mailed to which nobody later refers?

How many afternoon telegrams and long-distance calls can be avoided by having "rush" matters handled by letters dictated, typed, signed, and *mailed* by 10 A.M. or 12 noon?

How many letters (particularly letters with bulky enclosures) go out late in the day by air mail which could just as well have traveled by ordinary postage if attended to earlier in the day?

Can telegraph and long-distance telephone costs be reduced by routing a

carbon of every telegram across the desk of someone high in authority and by requiring that a memo be sent him justifying each long-distance call?

Are all top executives cooperating in minimizing telegraph, long-distance, and air-mail expense, or are they setting an extravagant example to their subordinates?

Are all letters to each salesmen or branch office—except those on rush matters sent out earlier in the day—collected together and mailed at minimum postage in a single envelope?

Can a saving be made by having addresses printed or processed on the envelopes to save stenographic time?

Because filling out call reports uses up time and energy, restudy the information you require from these angles—

- Are any of the questions out of date in terms of today's business situation?
- Are the questions asked boiled down to include only those which bring in information of real value to the home office?
- Is there any systematic procedure to utilize the information contained in call reports?

Does your accounting control watch salesmen's costs carefully? There is a detailed description of the way to do that in Chap. 11.

How to cut your delivery costs

You should organize for more efficient, more economical delivery.

The first job is to get a factual study of the advantages and disadvantages *to you* of various methods of shipping.

You have to consider every possible type of delivery: motor truck (your own or by established truck lines), parcel post, cash and carry or customer pickup, messenger, bicycle, motorcycle with sidecar or trailer, pushcart, and many others. Each should be studied to find—

- Costs
- Speed
- Convenience to customers
- Protection to you against damage or loss
- Effect, if any, on speed of collections
- Suitability to the size and weight of your normal shipments
- Usefulness in emergencies

Cutting your costs assumes you know good practices and are open for suggestions. It assumes you are watching rates offered and rates charged. It also assumes you are keeping watch against sources of trouble such as—

- Shipping department delays
- Damages due to faulty packaging
- Errors in addressing
- "Short" shipments
- Shipments not in accordance with orders

It assumes, too, you are carefully guarding against wasteful practices such as—

Using more wrapping paper than the package requires
Using needlessly long strips of gummed tape
Using excessive amounts of twine or string
Adding unnecessarily to parcel post and express costs by superfluous or poorly selected wrappings

If we can start on that premise, here are a lot of cost-cutting suggestions. Some of these may apply to you:

Should you give an allowance to purchasers who call for the goods they order?
What are your opportunities for substituting deliveries by boy on street car, bus, or bicycle for truck delivery?
Can you drop daily delivery service in favor of delivery scheduled every other day or twice a week?
Make no deliveries on half days. Induce customers to order their half-day requirements for delivery in the preceding day's delivery
Find out exactly how far you can deliver without eating up your profit. Then establish that distance as a rigid limit
Should you make deliveries within two or three blocks of store by pushcart instead of truck?
Consider adopting the "carrying loop" of twine, so widely used in prewar England, to help your customers cooperate in carrying home their purchases
Can incoming packages and containers be reused?
Are you buying any "padding" or cushioning materials that can be replaced by waste and scrap salvaged from your own operations?
If you operate your own trucks—
  Make an effort to arrange loads for return trips
  Provide for constant checkup and expert maintenance either in your own garage or best nearby service shop
  If your truck has idle time, find out where additional trucking capacity is needed in your locality and rent it out
  Discourage customers from insisting on special deliveries. Show them the imperative necessity for accepting scheduled stops on scheduled routes. Don't attempt to maintain "same-day" shipment unless it can be done without increasing costs, adding to traffic congestion, or wasting mileage
  Reduce number of pickups per day. Get down to one per day if possible
  Plan for capacity loads by concentrating shipments

How to improve your customer relations

Of first importance is to check on customer attitudes toward you. Do cus-

tomers believe that: their orders are slighted and other purchasers get first deliveries; your service or credit rules are oppressive?

Organize to sustain customer goodwill. Make sure your correspondence is carried on in such a way as to do a selling job for the future. And do this:

Be sure the character of your handling of deliveries, orders, credits, and remittances is in keeping with changed conditions
Express appreciation for prompt payments
Be sure complaints are dealt with promptly and humanly
Thank good customers for business—don't let cranks monopolize your attention
Make friends of all who contact you even in the humblest way

Keep studying lost sales and lost customers. Don't depend on other people to keep you informed of customers' preferences. Find out for yourself. That assures a continuous tabulation of reasons given for lost sales. It assures a review of the score, made frequently and open-mindedly, to ascertain if: your popularity is slipping in comparison with competition; users are alienated by your selling, service, or credit policy.

How do you guard against the easy-to-acquire tendency to underestimate the quality of competitors' merchandise, the ability of their salespeople, the sales appeal of their advertising? Part of the job, when others are competing with you, is to make open-minded comparisons. Part is to organize a system warning you when you are losing an account—particularly one ensuring that you will be notified when a "star" customer's account shows signs of tapering off.

As soon as it is evident that an account has stopped buying, try to find out exactly why. Move this way:

If what you find out suggests that you, or your sales method, *may* have been at fault, offer restitution promptly and pleasantly
If you have no reason to question the buyer's sincerity, give him—or her—the benefit of any doubt, the *first* time
It is usually better policy to let a habitual shyster crook you *once* than to take a chance that an *honestly* disappointed customer can criticize you to his associates and friends
If you suspect that a salesperson was the reason for the lost sale, consider assigning the account to another representative
Study carefully the collection record and correspondence over the last few months before the breakoff. Resentment over collection policies and methods is a frequent cause, but one which the lost customer will rarely offer as the reason

If direct action won't get the reasons for lost sales, maybe an advertising agency, not identified with your company, can get the information. If not, here are some ideas:

Put lost customers' names on follow-up ticklers to get specially dictated letters—the more personal the tone, the better

Use every opportunity to send letters with a "news flavor"—news items, new policies, new personnel, news services, new floor space. In other words, build up a definite impression of progress and improvement

Have someone other than the salesman write letters at intervals, asking if they were in any way at fault for the customer's discontinuance of the account

Try "anniversary" letters—on date of customer's first purchase from you, on your firm's birthday, just before New Year's, etc.

Try handwritten letters from yourself, a blank monthly statement with question mark or query as to why it is blank, letters with stamped return envelopes, etc. Be as ingenious and original as you please—you have nothing to lose but much to gain. "Stunts," by amusing the recipient, may accomplish what the dignified approach fails to achieve

Offer some useful premium for a frank statement as to why the customer has stopped buying—memo book, special calendar, or suitable novelty

When you have a selling piece for mailing, attach a handwritten memorandum carrying your name or initials, and address the mailing to a definite individual in the organization

If the lost customer is a business house, watch for opportunities to be of unexpected service—mail them sales tips, clippings of articles, or news items which should interest them but which they might not see in their own reading

At intervals give a lost account an opportunity to "pick up a bargain" of some item of which your supply is too limited to make a general offering

11. HOW TO OPERATE A PLANT PROFITABLY

How to run a small plant profitably is a many-sided study. It has to do with your production efficiency, your ability to market, your purchasing, your labor handling, and many other elements of good management.

This section of the book is a check-listing of the essential procedures that can be adopted to cut costs and improve sales.

Much of the approach here is in the technical aids toward a better, more profitable plant.

Much is in the plea that good management and good accounting information are synonymous. If you are to have intelligent operation, you need your CPA to show you how your records of supply costs, other plant costs, sales costs, and distribution costs can be made vital to your control. You need to get—

- Systematic reports, immediately rendered to every person concerned with costs. And they should be in terms they can understand, so that they guide the way to intelligent planning
- Accurate costing—preferably the sort that compares your results with decent standards you ought to adopt
- A method of red-flagging all variations from good practice, so you can quickly change bad spots
- An intelligent study of the way you sell, as well as the way you produce. Both are needed to cut unprofitable lines, unprofitable markets, and unprofitable customers
- A constant check of all wastes, spoilage, employee frauds, idle time, bad buying, bad supply handling, excessive absenteeism, inferior materials, incompetence, and other bad conditions that cause so much distress in small business

Good small-plant management also is concerned with the effectiveness of location, layout, use of equipment, use of service facilities, purchasing, receiving, storage, and accident prevention.

All these are first checklisted here.

Guides to good plant location

What about the community and the site? A community friendly to your kind of a business is important. Are its taxes reasonable? Will it make any concession to bring you to it?

Check existing climate, flood and hurricane possibilities, local noise, odors, dust, smoke
Check local ordinances as to hours, smoke, fire hazards, and sanitation
Note whether facilities for fire fighting, policing, sewerage, sanitation, etc., are adequate
Who are your neighbors—do you want to be near them?
Is the supply of water the type you need?
Check the fuel and power available
Is extension of plant possible if you require it?
Study the natural contour of the land, character of the soil, and its drainage to see if they permit more economical manufacture and should influence your decision
Check insurance costs in the area

Even a small town may have *zoning restrictions.* Size up a town to find out if there are any that would affect the location of your shop. Plentv of good spots should be available outside the restricted areas. Sometimes, when there is a very good reason for it and the neighbors do not object, the town may consent to rezone a portion of a district to permit the location of a shop. If a shop is noisy or if it emits strange odors and gases, it can easily be a nuisance to the neighboring stores and shops and may cause them to lose business. Then the zoning laws might be used to force the offender to leave the neighborhood.

What about *traffic?* Many towns restrict the use of their streets for heavy trucking and permit it only on certain routes. Think of this:

If the shop is on a truck route, the company that will be delivering most of your supplies may be able to drop off the load at your door
If you are located on a street where heavy trucks from out of town are not allowed, you may have to pay an extra charge to a local trucker or go to the trouble of picking up the supplies yourself
Your time is too valuable to spend on picking up deliveries. Check with the principal suppliers and find out whether or not this particular precaution applies to you
Rents may be cheaper along streets where heavy trucking is permitted because there is likely to be less competition for space
Most families do not like to live where the noise of heavy traffic bothers them day and night and comparatively few businesses find such locations desirable

Proximity to a freight station or a railroad unloading siding is often of considerable importance to a business. Many of your materials and supplies may be coming in by freight. Frontage on a railroad siding may be necessary if you are going after big jobs or heavy work.

One practical advantage in receiving materials by rail is that an l.c.l. (less than carload) shipment can be left in the freight station for a certain period

of time before storage charges are levied. If you are short of ready cash when a c.o.d. shipment arrives by railroad, you may have time to do the necessary collecting after you have been notified that the shipment is on hand.

Stay close to your market in picking a location. Be accessible to your customers if that is possible. But more important, think of these points:

Flexibility of transportation methods in case your particular system won't work
Traveling expenses of your own salespeople in their trips to the plant
Transportation costs and licenses. Measure costs of warehousing and storage at distant points against location of facilities there

Consider the labor problem in your location. The supply should be adequate, skilled, and at a wage rate suitable for your job. Think of these points, too:

Are housing and transportation facilities suitable?
Can you use the female labor available?
If you are going to move, what is the cost of taking your key people with you? How will they be received at the new location?
What training and vocational schools are available in the neighborhood?
Are restaurant facilities near you? If not, you may have to build them

Should you lease, buy, or build your plant?

Leasing has many advantages. The initial investment is lower, leaving you more cash for equipment and operating costs. There is less probability of your needing a bank loan. You enjoy freedom from such ownership risks as fires, tornado, or value changes.

Ordinarily you would build only if space requirements are not obtainable or no existing plant could be bought on favorable terms.

If you buy, your financial position must, of course, permit the investment. Keep in mind possible needs for plant expansion as the business grows. The time to check on sufficient space for expansion is *before* you buy or lease.

What about lease provisions? If the location has been carefully selected and the rights and obligations of owner and tenant are fully and clearly agreed upon, in writing, you need have no hesitation in signing a lease for 1 year or longer. Try to reserve the right to renew the lease for a fair period by giving notice before its expiration.

Should you sign a lease for more than one year? It may happen that the building selected will require extensive alterations. The alterations may be paid for by the property owner if he has an occupant who promises to lease the place for a term of years. No such concession can logically be demanded on a short-time rental or lease agreement.

On some long-term leases, provisions are included which permit the rental rate to be increased at stated intervals. The amount of the raise may be arbitrary, or may depend on the profits of the business, or some locally recognized index of business activity.

Responsibility for maintenance of repairs to the building, the roof, plumbing, floors, walls, and other parts should be clearly agreed upon. The owner and the tenant may have opposing points of view on this subject and any differences should be brought into the open and fully discussed.

What about rental rates? It is just as important to avoid extravagance in rental payments as it is to avoid miserliness. A man is proud of the business he is establishing and of the personal technical skill upon which he counts to make that business a howling success. He naturally wants to dress it up to reflect his confidence and pride. Remember these points:

- A reasonable appearance of economy is no liability to a new business. People are essentially conservative and will mistrust a new business which has spent too much on flash
- Rent has to be paid every month whether or not the business is making a profit. Therefore, rent is going to be one of your major items of fixed expenses. Don't cut down a limited working capital by obligating yourself to pay a discouragingly large rent bill every month
- High rent may not seem important during a period of good business—a prosperity cycle—but it may strangle your business if a slump comes along before you have been able to accumulate adequate reserves

Is there any "catch" to the property you are planning to lease or buy? Specifically: are sewer connections available? Is the road paved so that access is possible at all times? Is there ample police and fire protection? How near is the property to a fireplug? If you buy, is the title clear? Before making a considerable financial investment in the community, it is important to know just what your tax dollars are going to buy that will be of direct value to you. And what about these things:

- Is the town generally favorable to the establishment of new businesses? The leading citizens of some towns resent the introduction of new businesses and try to block the issuance of a license to a stranger. The old-timers control everything, own most of the property, and run the town council. Keep out of such a town and save your bank roll, your courage, and your optimism. Some other community nearby may be a better place in which to establish a new business
- Before you consider any building be sure that electricity, gas, and water will be available at all hours and seasons in the amounts required
  - Is ample pressure maintained at all times?
  - Find out whether or not the water charge is included with the rent; if it is not included, learn whether water is sold at a flat rate or on a metered basis. In some places water rates are extremely high

The cost of commercial electric current may be a measure for determining how much of the shop equipment should be electric powered. It may be necessary to buy a diesel generator set to ensure ample current for the shop's power and lighting requirements

Most cities have blighted areas, usually old run-down residential districts on the fringes of the commercial section. In these districts hoodlums, petty thieves, moochers, panhandlers, and hobos may be numerous. The presence of such persons not only complicates the plant-protection problems by day and night but tends to keep timid customers from visiting the shop even by day

In such an area, petty thievery might make it impossible to store bulky materials outside the shop; tools might disappear too often. The disadvantages and losses might amount to more than could be saved on rent

Older cities are often situated on the lowlands at the fork of two rivers. Some sections of those cities may be imperfectly protected against flooding in time of high water. The record of a location with respect to the inconvenience and damage caused by floods should be investigated

Some entire cities are below the level of the river levees and suffer periodicall from uncertainties due to weather conditions. Even in cities which are not in the river bottoms poor surface drainage and lack of storm sewers can lead to damage from heavy rain or high water

Aids in selecting the building for your plant

A factory or industrial type of structure is preferable to space in a business block or commercial type of building.

For *floors,* seek concrete. The concrete floor may itself be a sufficient foundation for light machinery if the foundation bolts are set in cement.

The thickness of the concrete should be checked. Drill a hole through it if it can be measured in no other manner

Heavy loads should not be trusted on it unless it has a safe margin of strength. In comparison with concrete, wooden floors, whether of planks or blocks, are not as strong, durable, stable, or level

While wood is softer and less tiring to the feet, it is likely to become oil-soaked; then the wood floor is extremely inflammable. You can't afford such risk of fire

Ordinarily a ground-floor location is preferable, as it lends itself better to the provision of proper foundations for machinery

Ample footings are especially important in the case of machine tools. They are assembled units and their parts can be thrown out of alignment by unequal lagging.

Poor alignment creates strains and vibrations which make accurate work impossible

Level, nonsagging floors are also necessary for maintenance of close tolerances for welding heavy assemblies

These conditions may not be found on upper floors, except in the case of a steel and concrete building

Your first effort should be centered upon finding a ground-floor location either without basement, or with only a part basement in which the heating plant is installed

Examine the *ceiling*. If it has exposed steel beams, that's all the better. To unload equipment and, later on, to load and unload heavy pieces of work entering or leaving the shop, a chain block or hoist is required. This hoist should hang from a beam strong enough to carry safely any load it will be called upon to support. Such structural features are not generally found in a commercial business block, and laboriously sliding or rolling heavy loads off or on a truck can add up to a lot of expense. Loading also slows down work, and takes men off more important tasks.

What about *walls?* Proper consideration of the natural lighting of the building will pay dividends in the form of lower electric bills, better work, and lessened eyestrain. Saw-tooth roofs were developed to permit a great deal of light to enter the interior.

A light-colored paint on ceilings and upper walls helps to reflect the light to working spaces, and makes the whole shop look shipshape, efficient, modern, and well managed.

The question of what color of paint to use on the inside walls and ceiling is worthy of special planning.

Light colors are best for the ceiling and upper walls

Lower walls which come in the normal range of vision should be darker in color, so as not to cause discomfort from glare

Reflecting values of different colored surfaces are as follows:

Color	*Light reflected, per cent*	*Color*	*Light reflected, per cent*
White (casein)	90	Buff	55
White (flat)	84	Light blue	52
White (eggshell)	82	Medium green	49
White (gloss)	81	Tan	48
Ivory white	79	Medium blue	49
Cream	74	Orange	40
Aluminum	73	French gray	32
Ivory tan	67	Dark red	14
Light green	62	Dark green	10
Yellow	60	Dark blue	9
Light gray	59	Black	2

Windows are very important and are likely to be found properly placed, or can be easily installed, in the industrial type of structure.

Have plenty of windows and keep them clean, not just for the sake of appearances and good housekeeping, but also because cleanliness will pay dividends in many ways

Good light from windows will cut down your electric bills, lessen the possibility of accidents that could result in loss of time as well as injury to an employee, and help to prevent mistakes in measurements
If the window and skylight area take up less than the equivalent of 30 per cent of the floor area, the daylight inside the room is insufficient
Actual measurements have demonstrated that vertical windows lose half their efficiency if left unwashed for 6 months
If they are sloping, the light loss is much greater and might be as much as 83 per cent in 6 months
Some three-fourths of the dirt collects on the inside of the window. A washing is especially desirable in the fall of the year when the days become darker and shorter

What about *entrances, aisles, available headroom, or interior space?* A cramped interior tends to restrict the amount of work which can be carried on or which can be stored until such time as it is repaired or shipped out.

Crowding prevents the natural growth of the business
It makes good housekeeping difficult, if not impossible
Plenty of space should be provided both horizontally and vertically
It is better to allow for too much rather than too little
Employees' time can be more efficiently utilized if the shop is large enough to accommodate a number of jobs under way
Both time and money can be lost in having to move unfinished jobs around to make space for new or rush ones

The *size of the entrances* is also of prime importance. Can the largest truck used for delivery purposes by your suppliers drive inside to be unloaded? Can large castings brought to the shop be trucked inside and easily unloaded without excessive hand labor? Can the door be opened easily by one man for entry of trucks and is there a smaller door for persons to enter or leave?

Large entrances also supplement the shop's lighting and ventilation facilities
They offer easier escape routes in case of fire, explosion, or other unusual hazards

If the space occupied is only a portion of a large building, *are there fire doors and fire-resisting walls* between your space and the rest of the building? Make certain that your fire-insurance rate will not be excessively high because of a neighboring occupant's type of business. In case of doubt have an experienced insurance agent check the building and advise what the insurance will amount to and what, if anything, can be done to reduce the rate. Small technicalities, easily corrected, sometimes increase insurance rates excessively.

Wide *aisles* are essential along all traffic lanes in a well-managed shop.

Often the aisle edges are painted a light color, and employees are prohibited from stacking anything in this space

Work is speeded up, accidents reduced, and damage to work lessened if hand trucks operate only on aisles marked for them

Passageways should not be skimped when estimating the floor area required for the shop at the start and as it grows

Shafts, housings, pillars, braces, or other dangerous projections which extend into the aisle space and which cannot be removed should be painted in attention-compelling colors. Yellow and black bands painted on such obstructions will prevent collisions. Use yellow striping also to mark the edges of open pits, elevator wells, and so on

How you can get the most efficient lighting for your building

When the equipment has been installed, you will probably have to call in the local power company to ensure that all general lighting and special job lighting will be properly placed and in the right amounts and intensities. Excellent artificial lighting costs about 1 cent per hour per workman. It is poor economy to work in badly lighted premises.

Study the light requirements necessary for each type of your work, and whether your system is adequate at a low cost

Consider the surroundings, presence of vapors, character and color of work, and effect of light upon the product

See if a relatively simple relocation of present fixtures, change of both type or size, or addition of some gadget will be sufficient to furnish adequate light

Consider whether supplementary lighting may be advantageous and economical at points where needed

Observe what the conditions are with respect to glare, within and without, and what can be done to improve them. Glare is costly

Note the places where change of ceiling and wall color would improve light

Use the appropriate standard for normal requirements—

- 5 foot-candles where not required to see small details quickly
- 10 foot-candles give good light on light-colored surfaces
- 15 foot-candles make for fast and accurate production in all but the most exacting work
- 20 foot-candles for average paper work
- 50 to 100 foot-candles for high precision or very fine inspection

Be sure it is the lighting system and not rearrangement of equipment that is necessary: get work benches, inspection tables located to take full advantage of natural light; see if additional windows, prism glass, glass brick, or monitors can be introduced with advantage

If you are redesigning a building, get a full report on the best modern practice in shape of buildings, size, location, spacing, type of windows, monitors, and other features for maximum utilization of natural light

Study the newer lighting systems—mercury, vapor, fluorescent—they often produce excellent results at low costs

To discourage theft of bulbs, use 220-volt lighting current, if possible. It takes bulbs which cannot be used in homes wired for 110-volt current

The machinery and equipment will, naturally, have to be provided with motors suitable for the kind of electric current available.

Power costs can be exorbitant unless studied constantly. Make use of the competitive information generously supplied by the manufacturers of your equipment. Here is the way to save money on electricity:

Fit the motor to the job
  Have the motor big enough but not too big
  Have most efficient motor drive machine, then run the longest hours
  Group several loads on one motor
Meter electricity to hold down waste
  Meter machines where function load seems to "creep up"
  Meter departments and charge them with actual consumption
Check feeders to cut losses
  Equalize loads, test insulation, prevent heating by spotting overloading
Boost power factor
  Look for motors too large for their loads
  Perhaps install capacitors
Schedule loads to cut peaks
  Examine necessity for load that constitutes a peak
Give electrical system adequate maintenance
  Systematically clean, inspect, and repair
Check your motors, bearings, insulation, mounting, lubrication
  When you shift a machine or relocate it
  Check motor starting characteristics
  Review lubrication and maintenance routine

This kind of planning removes all guesswork. You know definitely whether your building is satisfactory. Some minor compromises will have to be made to fit your flow sheet to the available building. Think of this, too:

Is there sufficient area to take care of parking, an irreducibly small scrap pile, a stock of heavy, bulky secondhand steel shapes you have picked up for a song but cannot comfortably store inside?

Is there space in the street or alley for delivery trucks to back in easily?

How easily can the shop be broken into by thieves or hoodlums? Some of the windows may need bars, which you can make and install at little expense

Is there adequate drainage? If the yard is in good condition, some jobs can be done outdoors in good weather. If it is not paved, perhaps a thick layer of cinders, properly graded, will be sufficient

How does the building look from the outside? Some paint might be a good investment and would not displease the property owner either

How to lay out a plant

The shop as a whole is a production machine. It must be suitable for the work it is to turn out. To make certain of that, a production analysis is necessary.

Consider what will be: the flow of work through the shop; the processes through which the material must pass and their order; the number and sizes of machines or equipment required; and the volume of business which must be handled in order to ensure financial success of the venture.

Determine what type of organization or grouping of machines is most suitable for you. Two methods are available:

Straight-line or unit production is advantageous—

If your product can be broken down into units taking substantially the same equipment and sequence, and the volume and continuity warrant. It gives you a chance to plan a continuous stream of units moving forward in natural sequence

When engineering and scheduling can switch a line from one unit to others of the same kind

Where units of different types must come together for subassembly

Where there is some high-priced or special class of work not used continuously and several lines may be set up

But recognize that while straight-line or unit production is usually the most efficient, you must check its tendency to incur excessive investment in tools and equipment

Functional arrangement or job production is advantageous—

If you manufacture a variety of products, and quantities are relatively small

If departmental grouping is by kind of machine

If you seek greater flexibility, maximum machine usefulness, more skilled operators, and less supervision and training problems

But this scheme will usually magnify problems of handling, counting, inspection, production control, and coordination between departments

If the layout is clumsy and amateurish, your production machine will function in an awkward and inefficient manner. A well-planned flow of work through the shop will decrease the labor cost, shorten hauls between machines, cut down the time of work in process, lessen space requirements, facilitate inspection, and encourage such neatness and orderliness as can reasonably be expected in a workshop. Use these guides:

Make an analysis of operations necessary to production

Usually the heating system is designed to combat the average low outdoor temperature rather than extreme low temperatures. It is not likely to be damaged by being overworked during short spells of unusually cold weather

Temperatures which should be maintained for efficient working conditions are approximately as follows: Machine shop, 65 degrees; welding shop, 50 to 60 degrees; and office, 70 degrees. Extremely cold days seldom exceed 5 per cent of the heating season; cold weather averages 20 per cent, and mild weather 75 per cent

Health and comfort demand a proper circulation of air in summer and winter. Ventilation cannot safely be left to chance alone, especially when there are noxious fumes in the air

In some places, such as engine and boiler rooms, the air has to be changed every few minutes. In the average shop about 1,200 cubic feet of air per person per hour is needed to provide proper air sanitation

Installation of a hood and blower, to eliminate dust and fumes at their source, may provide sufficient air turnover for the whole shop. Humidity is best maintained at 50 per cent but can range safely from 35 per cent to 80 per cent in ordinary shops

If you content yourself with poor ventilation in order to "save money," you lose the price of good ventilation many times over in lessened output by your employees and an increased amount of spoiled work and scrap. If natural ventilation through doors, windows, and skylights is not dependable, it should be supplemented with exhaust fans and, if necessary, with ducts which will reach the bad spots. Consider these points:

Where required, air can be circulated over ice

Spraying water on the factory roof after exposure to a very hot sun sometimes gives relief at low cost

If your processes require controlled air conditions which call for special handling, study the problem with the manufacturers of equipment. They will supply full information about the fully mechanized refrigeration systems available

Consider whether normal air currents aided by such help as you can secure from windows, louvers, and ducts will be sufficient

If suitable, air conditioning can be attained through the use of exhaust fans to remove bad air and intake fans to draw in fresh air

If the air is dry, find out if you get better conditions by restoring humidity —preferably to a level of about 50 per cent

Recognize that bringing in air at high velocity, lowering moisture content, circulating saturated air at low temperature, are aids to ventilation

Remember that air cleanliness reduces fatigue and helps prevent occupational diseases

How to get employees' cooperation in eliminating accidents

The cost of industrial accidents is little understood and generally underestimated by most small-plant managers. If they carry insurance, they are likely to think of the cost as the cost of premiums only.

If they pay compensation and medical expenses directly, they think only of those costs. As high as premiums on insurance or direct payments for compensation and medical expenses are, they are only a small part of the total costs of accidents. A rule-of-thumb measure is that for each dollar of direct costs for compensation plus medical expenses there are four additional dollars for indirect costs. To many this will seem incredibly high, but indirect costs involve many factors. To name some:

- Lost time of injured employees
- Lost time of fellow workers who stop work—
  - To aid injured worker
  - Out of sympathy or curiosity
  - For other incidental reasons
- Lost time of foremen and managers—
  - Assisting injured employee
  - Investigating cause of accident and preparing accident report
  - Arranging for continuance of injured employee's work
  - Selecting and training new employee
  - For serious or contested cases, attending legal hearings
- Lost production or damage to product or materials due to upset, shock, or diverted interest or workers
- Lost production due to stoppage of machine or process in charge of injured person
- Damage to machine, equipment, or material
- Lessened effectiveness of injured employee for a period after his return to work
- Legal expense, court fees, expense of preparing case, settlements and judgments in cases contested at law

Many small-plant managers do not know what these accidents are costing them and do not feel they can afford a safety program. Statistics prove that the costs of accidents in small plants are high enough to demand a program for their reduction. In recent years, many small plants, with the assistance of safety organizations, have developed successful safety programs without undue expense or additional personnel. Each of these programs is devised with the application of certain basic principles. Modern safety engineers have discovered that these principles must be adhered to in developing a successful program within any small plant. These principles are—

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Study the problem until you are fully convinced that it is possible and worth while to eliminate accidents. Unless you are sold on a safety program, your efforts will be halfhearted and this attitude will be reflected by lack of co-operation from your workers. Any attempts to promote safety without evident and sincere determination to succeed will be paid lip service only. A safety program that has to be abandoned will make it difficult to initiate another program at some later date.

Ask for assistance from the nearest office of your State Department of Labor, insurance company, or trade association. They can help you analyze your accident problem and assist you in planning a safety program that will reduce unnecessary costs. They will generally do it without charge. They can provide information and guidance on instruction to your employees, on methods of safety inspection, the development of a safety committee, and control of mechanical hazards, and can help effect a definite improvement in your accident records.

Learn how to recognize hazards of all kinds, how to locate those that are not self-evident, and how to remove them or safeguard employees against them. Some of the factors which need to be considered in accident prevention are—

Machine safeguards

Plant construction, layout, and arrangement

Unsafe practices of employees, including those involved in housekeeping of plant and machines, maintenance, use of hand tools, lifting, carrying, and working on scaffolds, ladders, or other elevated places

Possibility of fire, explosion, and electrical shock

Special occupational hazards

Sell safety to all employees. This is the most important and at the same time the most difficult phase of accident prevention. It cannot be done overnight. Safety must be encouraged, demonstrated, and insisted upon every day until each person is safety-minded and has formed safe working habits. Some of the ways of selling safety to employees are—

Recognizing that safety is a responsibility of management and should be planned as a part of the plant operation. Directing and giving encouragement to the program

Organizing, guiding, and encouraging safety committees and delegating responsibility through them and through supervisors

Publicizing the problem, the program, and its results through group meetings, talks, posters, and bulletin boards

Supplying safety information and knowledge through committees, meetings, talks, posters, written instructions, sound slide films, and sound movies

Keep records of accidents. These records will serve a number of purposes, such as—

Providing information for a study of causes and frequencies

Estimating total cost of accidents for consideration with profit-and-loss statement

Identifying workers who have an unusual number of accidents
Indicating progress and success of safety program

One of the best ways in which you can gain the worker's interest in safety is by eliminating those hazards over which you have direct control. The realization that you are doing your part in providing the workers with safe working conditions will make them more receptive to a safety program. A basis is thus provided for employee cooperation. They will be more willing to do their part in maintaining safe working conditions and to support the entire safety program. Commence work in the following areas:

Accompanied by some key workers, make an initial safety inspection of the plant. Even though you have not had safety training, you can recognize many situations as being dangerous if you will study them closely

Some hazards that may not be found by such inspections may be discovered by safety engineers or inspectors who can be brought in from state labor departments or insurance companies. These often are asked by safety-minded managers to analyze safety conditions in the plant, make detailed safety inspections, and recommend corrective action

Once hazards are recognized, corrective action may be taken to eliminate them. It is sound business practice to do so, since safety and efficiency always go together

This process of inspection and elimination of hazards is a continuous one, since new hazards may be created by a change in operation or old hazards may reappear

Then plan or replan your layout and arrangement intelligently. Proper planning of the original plant layout and adequate control of operations theoretically would eliminate all accidents

Many firms have come very close to that goal. At the time the plant is built, safe working conditions can be provided for without additional difficulties or expense, since the most efficient operations are usually the safest

Changes in layout or operations of existing plants are indicated for reasons of safety and efficiency when materials pile up at certain points, when the paths of materials in process cross each other, when employees do not have adequate working space, or when other similar conditions become apparent. These changes, particularly if they are major rearrangements in plant layout or operations, cost so much that another change is not practical for some time. This emphasizes the importance of planning all changes carefully so that other dangerous conditions are not created by the change

Poor lighting of buildings, rooms, and passageways is responsible, directly or indirectly, for many accidents. Where conditions do not admit of constructive improvements, liberal use of white paint or frequent application of the whitewash brush will be of much remedial value. Light-reflecting wall sur-

faces do much to help the diffusion of available light, whether natural or artificial. And note this:

Where natural light is not obtainable or sufficient, artificial light should be liberally provided. Three systems of artificial lighting are used for industrial shops. They are: local lighting, general lighting, and general lighting *plus*.

With local lighting little attention is given to general illumination of the room but an individual light is provided for each worker. This system of shop lighting was one of the earliest. However, it is rapidly being supplanted by general lighting. Local lighting throws abundant light on the work, but leaves the rest of the room dark, thereby causing the pupil of the eye to adjust itself every time the worker looks away from his work. This constant adjustment results in eyestrain and fatigue.

General lighting calls for adequate lighting of the entire area, thus eliminating semidark areas and permitting greater eye comfort.

General lighting *plus* is a combination of general lighting and supplementary lighting. It is used where the type of work requires a higher level of illumination than could be economically provided for the entire area.

Plant housekeeping—cleanliness and orderliness—is a fundamental of good management. It prevents accidents by removing their causes.

In a well-kept plant, there are no loose objects on stairs, floors, and platforms, no articles that can fall from overhead, no wet or greasy floors, no projecting objects in aisles, and no projecting nails or sharp pieces of metal to tear the workers' hands.

Where accident records are good, managers pay very careful attention to maintenance of plant, equipment, and machinery this way:

Floors are kept in good condition, without holes or splinters in them that might cause slipping, tripping, falling, or handling injuries

All portable equipment on which men stand, such as ladders, steps, horses, or scaffold planks are maintained in first-class condition

Chisels, portable grinders, and drills are kept free of defects or replaced.

Machine guards are properly made, installed, and maintained and the workers are instructed in their proper use

Machines themselves, as well as pressure vessels, electric wiring, and other equipment, are kept in first-class condition for both production and safety

Operations and methods are planned to eliminate hazardous situations and ensure adequate control at all times

Mechanical handling is substituted for manual handling. Often it is cheaper and faster as well as safer

Workers are carefully trained and adequately supervised to see that all supplies, products, and other materials are moved, carried, piled, or stored in a safe manner as well as an efficient one

Workers are protected from electrical hazards
Protective clothing and equipment, such as safety shoes, goggles, and gloves are worn by all workers on jobs where needed. Management usually supplies these items and insists on their use
A simple way to eliminate this hazard is to make sure that all circuits and lines are installed and maintained in conformance with safety standards

Whether a worker wears suitable or unsuitable clothing is a matter largely within the control of the employer. Keep watch on this matter. A ragged sleeve, a flowing necktie, a loose coat or jumper jacket, can do incalculable harm if caught in any part of a moving machine. Women should be required to confine their hair or wear adequate head protection when engaged in machine operations. For certain jobs special clothing (hand and arm protectors, shoulder capes, hats, caps, welders' aprons, coats, overalls, leggings, shoes, etc.) is necessary for both men and women operators. In the selection of such special clothing four essentials should be considered:

The garment should be reasonably comfortable when worn under the conditions for which it was designed
It should fit snugly and not interfere unduly with the movements of the wearer
It should offer adequate protection against the hazard for which it was designed
It should be durable, taking into consideration the severity of the conditions under which it is used

Safeguarding of mechanical apparatus is of prime importance. You must convince workers that guards should be installed on machines and used at all times. Those who have become accustomed to working on machines without guards often resent their installation and will remove them whenever possible. They must be convinced that the guards are necessary for their protection.

Workers who have been trained on guarded machines prefer them. It has been proved that the correct kind of guards invariably increase production through enabling machines to be operated more steadily, or faster, or both.

You should maintain emphatic discipline in the interest of safety, particularly with workers who: smoke when it is properly prohibited; drink liquor at any time on company premises or report for work under the influence of liquor; carelessly tamper with the safety protective devices. You need to be tough with those who disregard safety rules—particularly operating without full use of safety equipment or without authority. And post notices conspicuously describing—

How to start, operate, and stop equipment
What switches and controls must never be touched
Where fire apparatus is accessible

How aisles are to be kept free for use in fire
How waste is to be kept out of corners to avoid gambling with fire

Every shop should have a system for furnishing first aid to the injured. The effects of an accident may be intensified for lack of immediate proper care of the injury. Even more, unskilled handling may do further harm, in addition to causing unnecessary pain. Where it is not possible to have a thoroughly equipped emergency room, there should at least be first-aid supplies and someone trained to render first aid. Make first-aid facilities readily available all over the plant—see that locations are well known. Only those qualified should be permitted to administer first aid. Doctors' names and telephone numbers should be conspicuously posted; also name, location, and telephones of hospital.

How to reduce workers' fatigue to a minimum

Recognize that fatigue may be destroying your opportunity to keep workers in a period when you may want to hold tight to all of them. Seek out all cases of: physical exhaustion from excessive labor; accidents caused by downright tiredness; injuries, delays, errors, and omissions caused by factors such as poor materials handling, bad light, heat, air, and noise, poor seating or standing accommodations, and a lot of others.

You want to know the least fatiguing way for the operator to work. To find that, study surrounding conditions—the chair, bench, flooring, materials handling, lighting—and where accidents occur. Then couple intelligence with vigorous action to see what you can do about it, this way:

Provide the best possible equipment to cut down materials handling
Make sure of the fresh air supply
Make sure you have adequate light
Control your heat and watch humidity
Cut down noise as much as possible
Keep a supply of materials flowing to the work in a way to avoid needless stooping, bending, and lifting
Where the need for speed exists, insist upon frequent rest periods
Cut down noise by proper oiling and adjusting of machines
Look into noise and dust caused by your materials. Cheap materials are often expensive in their effect upon your people
Prevent accidents by improved training of new employees, especially young people
If you have monotonous jobs, provide frequent short rest periods. They will cut down on time spent on incidentals
Get rid of glare, shadows
Watch the effect of live steam, gas, poor oils

Provide chairs with good seats that adjust the work to the level of the worker
Furnish devices to curb intake of dust, odors, and dirt and insist upon their use
Put tools in a place where they can be reached without stretching

Weariness may effect both the quantity and the quality of work. Use the following "indicators" with caution, as the personal equation is a variable that upsets stereotyped calculations:

The length of the work week. A greater output may be effected by less hours in the work week
The length of the work day. Find optimum hours for your plant. Note that rate of production varies during the day; watch fluctuations in hourly output in your plant. Note that the number of "optimum hours per day" differs if your object is lower costs or if it is greater production
Absenteeism. Sick and voluntary absences are increased by fatigue
Accidents. They are an indirect measure of fatigue in industry
Labor turnover. It is increased by fatigue; rest periods may decrease labor turnover phenomenally
Spoilage and errors. These increase rapidly with rising fatigue

How to get the best plant maintenance at lowest cost

To get the lowest cost possible, you want definite responsibility for maintenance. Delegate that to competent hands. Arrange for periodic reports of inspection and good records of maintenance. If you have not enough work to employ a full-time man, get regular inspection by a local service man.

Control of the maintenance costs must be maintained consistently to get the greatest economies. You must periodically examine your inspection reports and cost records.

Make sure that they show any excessive maintenance costs. Find the causes and adopt corrective measures
Trace product inspection troubles. You may find that a particular machine or kind of machine needs adjusting
Seek data on what stands up and what doesn't. Seek information that will suggest improved equipment and methods
Make sure your records tell you what items should be replaced

Preserve your *floors* by establishing a dependable cleaning procedure—

Keep cement floors wet but free of oil or grease deposits
Keep wood floors free of slippery soap, oil, or grease
Clean linoleum floors with mopping and the use of a good soap compound
Keep cork-tile floors free of harmful water deposits under the surface
Protect asphalt plastic floors from abuses for which they were not designed

Protect rubber flooring from harmful chemicals
Keep tile floors dry and protected from heavy trucking
Clean terrazzo and marble floors with a neutral solvent of penetrating and wetting properties and thorough rinsing qualities

Get the most out of your *machines* by maintaining them. That means an inspection procedure for all machines, to be carried out according to a definite schedule. It also means—

Operating machines at most efficient (usually maximum) capacity
Issuing definite operating instructions to all machine operators, telling them just how to start, run, and stop each machine, and what to do in case of certain failures
Knowing your machines and their individual capacities. Beware of overloads and check on idleness
Checking the accessibility of service and repair units
Keeping constant check on wear and tear due to faulty bearings and other unnecessary friction
Securing all pertinent maintenance information concerning each machine from the supplier or manufacturer
Keeping all working parts free of harmful waste, shavings, and other extraneous materials
Investigating immediately all undue vibrations
Having machines not in use properly shut down and protected
Establishing a lubrication routine that automatically prevents rust and unnecessary wear
Checking that power distribution to each machine is adequately controlled. Check the condition of all motors regularly
Checking frequently the accuracy of measuring instruments (temperature and oil gauges, scales, ammeters, etc.)
Inspecting all valves, pumps, joints, fittings, couplings, etc., according to a regular schedule
Having all necessary repairs made promptly
Checking the insulation and surface of all vital parts
Inspecting and testing fire and emergency equipment at reasonable intervals
Checking the efficiency of all shock-absorbing installations and devices
Checking to see if machining operations are properly supplied with suitable cutting fluids

Here are concrete suggestions for saving valuable and critical equipment—

Belts and belt drives
Keep record of location, specifications, dates of installation and removal, when taken up, history of adjustments, and other relevant data
Frequently check belt tension, service condition, pulley condition
Protect belts from injury

- Buy V belts in sets; never replace part of a set; use old ones with other spares
- Teach men not to let belt run over edges of pulleys
- Check alignment of shafts and other equipment for full contact of pulley surfaces
- Run endless belts in the way usually marked on them with the brand on the outside
- Use a 180-degree turn at the splice on quarter-twist belts; it evens wear and stress
- Be particularly careful about belt tension
- Be sure belt ends are squarely cut for splicing and always use proper belt fasteners
- Keep tensions low and alignments accurate and check these points by regular examination
- See that the bolts are tight if you use fasteners in conveyor belts
- Consider making conveyor belts endless by use of electrically heated vulcanizers
- Install grizzly bars to delay lodging of lumps on conveyor belt so that they will come after fines
- Use idlers in connection with skirt boards to facilitate yielding to impact of material moving over conveyor belts
- Wash dusty or greasy belts with soap and water; remove glazing with a cloth dampened lightly with gasoline and hold it against moving belt
- See that belts are never creased, folded, or sharply bent or strained during installation

Furnaces and steam lines

- Look into corrosion- and rust-preventing coatings now being produced
- Mount safety or relief valves as closely as possible to the equipment
- Tighten bolts evenly in the valve flanges
- Arrange discharge piping so that no strain is imposed on the valve
- If connections are screwed, use wrench on valve side of pipe joint
- Do not swage the discharge piping to a smaller size
- Clean valves with air or dry steam when installing, to save trouble from particles between seat and disk
- Be sure the pressure gauge with which the valve is set is correct
- Do not set with too little blowdown; about 4 per cent, not less than 3 per cent

Valves

- Repair leaky valves as soon as possible
- See that proper instructions are given for valve regrinding. It is economical and easily and quickly done the right way

Control and recording instruments

- Put all control and recording instruments in charge of one man. Have him—
    - Wind the clocks
    - Change the charts and ink the pens and keep them clean

Where possible, remove them from heat, fumes, or vibration
Cover where exposed to weather
Fasten any loose tubing out of the way to avoid damage
When installing gauges, apply wrench only to place on socket
See that piping leading up to gauges is free from strain
Use gauges of ample range; twice that of the working pressure
Protect from rapid pressure fluctuations by throttle screws or needle valves

Motors, motor housings, slip rings, commutators

Wipe off motor housings, slip rings, commutators
Occasionally blow dust out of wound sections of motors with low-pressure compressed air or hand bellows
If you use air, see that it is free from grit, metal, or moisture
See that oil filler caps are closed, dust seals and gaskets in good condition
Use care to confine oil to parts where it is required
If some escapes and becomes gummed with dirt, remove with a solvent (carbon tetrachloride); in using solvent, avoid soaking the insulation
Protect motors from moisture; where water has reached them, dry out in an oven or circulate current through windings (use a fan to force air through), or cover motor with a tarpaulin and provide heat with electric bulbs
To reduce friction, check lubricating more often in these days of longer operating; use enough oil, but not too much
Check alignment to avoid vibration as far as possible
Guard against overloading or underloading your motors; overloading will induce heat and damage insulation, and underloading will reduce your power factor and increase your bill beside putting a greater load on the lines
When a fuse is replaced, find the cause for its blowing first; it may be a stiff belt, tight bearings, unclean commutator, motor being brought to full speed too quickly, damaged motor, worn bearing, etc.
Don't overfuse; see that the contact on fuse block is good; use the right kind of fuse for the circuit
If a motor or generator has become wet, dry out thoroughly before operating
Do not raise the temperature above 90°C.
Place the stator in an oven and bake
Enclose the motor with a suitable covering, leaving a hole at top and insert heating units or lamps
Pass current at low voltage through stator windings
Dry out with portable infrared lamps
Continue drying until the insulation resistance becomes practically constant

Welding equipment and oxyacetylene apparatus

Keep metal seating surfaces of the blowpipe gastight

Keep these surfaces clean; wipe off carbon deposits left by flashbacks
Always use a wrench in making connections; never tighten by twisting the stem
Blow out cylinder valves, before connecting a regulator, by opening them for an instant to blow out grit and dirt
Ground the frames of all arc-welding equipment to avoid shock when a person touches the frame
Use adequate low-resistance leads
In the location of welding equipment, remember that ventilation is important; otherwise overheating may result, shortening the life of the insulation
Clean bearings, gaskets, and screws; use clean grease and not too much of it, to prevent bearing troubles in arc-welding equipment
Use correct sized torch tip, correct pressure, and correct diameter hose (preferably short length)
Use all the gas in the cylinders; keep cylinder inventories low
Close cylinder valves when not in use
Don't leave torches burning when not in use
Don't abuse cylinders; return empty cylinders promptly
Keep the tips clean and free from carbon and slag and handle hose with care

Electrodes

Protect them from dampness
Store them in their containers; do not stack directly on the floor
Leave 4-inch air circulation underneath
Empty one box before opening another
See that your operators use electrodes down to last two inches
Have your engineering department specify right type and size

Rubber tires

Inflate them properly
Avoid bumping into curb; it may leave a bruise
Have your wheels in balance and aligned and your brakes in adjustment
Have your tires checked every 1,000 miles for tread cuts
Switch wheels every 5,000 miles to even wear on tires
Torn or worn-out sections of tire tubes can now be cut out and patched by welding end to end by special vulcanizing process

Oil-burning equipment

Watch its efficiency
If possible, measure by proper instruments the energy output per gallon burned and compare with standard data
Watch for—

Formation of excessive soot or carbon
Cleanliness of combustion oil used
Proper proportion of combustion, air, and carbon dioxide produced
Excessive stack temperatures
Excessive or insufficient draft

Check on—
  Accumulation of soot on boiler surfaces
  Condition of water in the boilers
  Proper insulation
Scientifically examine your heat-distributing system as to—
  Mains and return pipes
  Proper placement of radiators
  Control devices
  Insulation of walls, ceilings, and windows
  Reflectors
Have an expert go over your oil-burning system in detail

Wire rope

Use right lubricant
Watch out for rust
To get better results, thin out lubricants by heating before applying to wire rope
Use a vat or special drip-oiling device if possible
If rope is operated at high temperature, use a thick lubricant, and apply it while heated above operating temperature

Fire hose

Have as few folds as possible
Run water through unused hose at least twice a year
Prevent truck from running over the hose when it is in use
Protect from chafing at section nearest fire pump. Try to keep from freezing
If it freezes, thaw out before bending
Get the correct size coupling and see that all burrs are removed
Cut hose end square when attaching socket-type couplings, to prevent fluid leaking and wicking through hose
Put the coupling in a vise and push the hose over the coupling; do not drive in with a hammer or mallet
Mount hose when coupled to hang vertically and relieve strain

Air-conditioning equipment

Keep it clean
Reduce power consumption by cleaning filters; install differential gauge
Use a small amount of chemical to prevent growth of algae and slime
Keep insulation repaired
Have a thorough inspection at the end of the cooling season and arrange needed repairs before another season
Give equipment a complete cleaning in the off season; keep dry and all dampers closed; be on guard against neglect at this season

Tools

Stretch their life by using them properly, and conserve tool steel
Tool steel to be forged should be heated slowly and uniformly
  Preheat before bringing up to forging heat

Cool slowly by burying in dry ashes, lime, or silocel protected from moisture or drafts

Anneal intricate shapes after forging to remove stresses

If previously hardened tools are being salvaged by reforging to make smaller tools, anneal before forging

Use correct angles in setting carbide tools to provide correct rake, back rake, and reliefs

Use the blade suited to the conditions in power hack sawing; check the number of teeth, strokes per minute, and feed

Get the manufacturers' data on setting saws, care of files, and proper usage

Use the right file; do not use too much power on the filing stroke; do not drag the file back under pressure

Keep files in a dry place; do not throw them into toolbox or stack them against each other

Increase useful tap life and decrease tapping costs by reconditioning taps

Do not put extended leverage on the wrench handle

Do not subject it to side strains

Do not use it in place of a hammer

Do not apply pipe wrenches on hardened steel; it causes wear on the teeth

Keep teeth clean and avoid useless wear by slipping from gripping too near the front or back of the pipe

Get repair parts for adjustable wrenches; reclaim those discarded

Use the right grinding wheel and make sure the setup is right on speed, coolant, traverse, rate of feed, etc

Never tighten file bands on wheels

They will cut more accurately without tension

They will last longer when not stretched

The file guide holds segments squarest when band is slack

In welding always cut the saw blade from the back

Trim the end so that it will be square

Use a butt welder in making a weld

Trucks

Keep records of performance and maintenance

Teach drivers how to stretch life of truck

If your truck or car has hydraulic brakes, have master cylinder of the brake drum checked at each lubrication period

Add fluid if less than half full

Have wheels pulled by an expert at least annually

Provide your truck drivers with a daily report containing check list of points to be watched

Standardize your inspection procedure to embrace certain definite points at 1,000, 5,000, and 15,000 miles

Keep a report on each inspection

If you have old light trucks, investigate what is being done to rebuild such trucks into heavy-duty carriers by installing tandems, rear ends, and special transmissions
Work out pooling arrangements of your trucks with neighboring plants

Some valuable pointers gathered from hard-bitten production men are:

Use corrugated tote boxes for small parts instead of metal ones
- Saves metal
- Is lighter for women to handle
- Eliminates injury from sharp edges and splinters

Improve and speed up production by using degreasing compounds where applicable—
- Preparing aluminum alloys for resistance spot welding
- Cleaning aluminum or magnesium before anodizing
- Cleaning castings and parts before painting
- Cleaning metals before and after heat-treatment
- Cleaning before pickling, wet grinding, and machining operations

Store prepared glue at room temperature in winter, in a cool place in summer
- In a cool climate anticipate winter quantities wherever possible; use old stock first
- Cover the barrel to prevent evaporation
- Keep containers, brushes, equipment clean
- Clean equipment thoroughly when changing from one glue to another

Salvage pipe flanges:
- Cut pipe near flange
- Cut a notch in remaining pipe
- Collapse with hammer; it falls out leaving flange threads unharmed
- Clean threads thoroughly

Repair steam rods from pumps:
- Turn off taper
- Reduce the inside of the stuffing box by a ring of babbitt
- Reinforce with a washer so the packing will not work

How to buy material and supplies most economically

Every dollar spent for material has to be earned back by the shop and carry a profit along with it. What are the rules for prudent buying?

You must plan for a rapid turnover. Slow-moving material and supplies may rob your business of money needed for fast-moving items—the ones that support you shop. Your inventory should be closely controlled. Budgeting your expenditures carefully will leave your funds free for more useful purposes. Here are some aids for small plants:

If you have to buy on a hand-to-mouth basis, it is important to patronize a firm which makes frequent deliveries and has fairly complete stocks. Stick closely to the supplier who can furnish the greater part of your requirements. That will entitle you to expect more consideration from him and will reduce the number of checks to be made out each month. It will also provide better justification for more favorable open-account privileges as time goes on.

To get good service from a supplier your business must be worth having. Spread thin among many, it will not be attractive to anyone. Mutual confidence between supplier and purchaser is the basis of all successful business relations.

Keep supplies of small items in stock even though these are obtainable quickly. Metal screws, wood screws, studs, bolts, and nuts will not tie up much money in stock and it is well to have them on hand. Just see that they are not thrown around carelessly. A glance at the floor sweepings will show whether they are being wasted.

Small cutting tools, drills, taps, and other such articles might well be kept under lock and key and given out only on surrender of the broken pieces for which they are being exchanged. That will also show whether tools which would otherwise have been thrown away can be repaired.

What are your sources of supplies?

Handbooks or data books issued by business papers and selling companies are crammed with essential information and should be in the files of any shop. Of importance are the *mill supply houses.*

They cater to factories and carry a complete line of materials and supplies

Since they sell in large volume, they buy their own stock at the most favorable prices and terms and so can sell to factories at or near ordinary wholesale prices

The catalogues of these houses are valuable to have, especially when you must find a source for some item not previously purchased

The types of stock carried by mill supply houses are determined to a great extent by the principal class of customers served and so may differ from city to city or even within a single large industrial district

Conversations with the salesmen who call on you will soon inform you which of these houses can be of most service

Many *wholesale houses* give special discounts to factory accounts. There is a certain zone in which the wholesale hardware house and the mill supply house are in competition with each other. Knowing this, the buyer for a shop can sometimes get discounts for which he would not otherwise qualify.

The ordinary *retail store* may be the logical source for small plants. But they need to give the dealer enough business to keep him feeling friendly. Usually he will give 30-day terms when the supply houses may still be de-

manding c.o.d. Since his profit margin is larger than that of the wholesalers, he can take more chances. He will give a shop owner a discount on almost any purchase, as he will expect to average only about 10 per cent profit on such business.

Direct purchasing from manufacturers may necessitate larger unit orders because of excessive express expense on small shipments.

Check the minimum freight charge against the rate per 100 pounds. It may take 150 pounds, for instance, to make a minimum shipment if the freight rate is 50 cents and the minimum charge is 75 cents

But be careful not to pad an order beyond probable need merely to take advantage of a lower freight rate

Verify also if the railroad has pickup and store-door delivery arrangements. Shipping by truck may be cheaper

The value of maintaining cordial relations with the *salesmen who call at a small shop* cannot be emphasized too strongly. Through them you can keep closely in touch with technical developments which will affect your business. Here are some aids:

Usually you will find that the salesmen follow certain schedules and count on making their calls at fairly definite and predictable intervals. Therefore, if at all possible, set a particular time during which salesmen can be sure of finding you in your office; then be there, even if it is not always convenient for you. And your allocated time should, by all means, take into consideration the travel habits of the majority of salesmen who stop regularly at your shop.

Regardless of your worries or frame of mind, give each salesman an open-minded audience, and listen to his story courteously. Tell yourself there is no man on the road from whom you can't learn something of value.

Whether or not you intend to give him an order, treat him as respectfully as you would a customer. If you are alert and on the job he can be useful to you. And he will want to be, if he is treated right.

The most helpful information will probably come from suppliers' salesmen. They call on the same factories you do—and many more—and from long experience can advise how to approach any certain one for business, what are the pet phobias of others. In fact, they can tell you any amount of the personal bits of fact or gossip which it took years to collect and which are remembered only as they have some bearing on getting business. These salesmen can even be of assistance before you set up your shop if they know you are contemplating such a venture. They can sometimes recommend favorable locations or possibly tell you about an established shop whose owner wants to get out of business and would sacrifice some of its value to do so quickly.

How to check frauds in your purchasing

Set up a good system of internal control of your purchasing methods unless you want to invite fraud and errors. Be sure you get what you think you are buying.

Insist on inspection of incoming goods on arrival. Keep the receiving end of your business separated from the buying end if you want to avoid collusion between your buyer and the vendor.

A Continental Casualty Company booklet lists as the more common methods of embezzling from an employer—

Paying bills to fictitious firms and cashing checks through a dummy
Issuing checks for returned goods which were never returned
Raising invoices and checks after they have been paid

As a result of many investigations, it urges that control is best had this way:

Merchandise is money. Because it can easily be disposed of for cash, either by direct contact or through a receiver of stolen goods, *the need for accurate, adequate inventory records is obvious*

Keep a card record of all merchandise, supplies, and equipment, with a separate card for each item. The record can serve for regular annual inventory or physical inventory of stocks. Physical inventories should be made quarterly by a responsible officer other than the custodian, receiving clerk, or shipping clerk

In addition to the regular annual inventory, it is also advisable to make a "surprise" inventory at irregular intervals. The ideal arrangement is a perpetual inventory of merchandise, supplies, and equipment, with a separate record for each place such property is kept

It is important that the *receiving department* be subject to check and control. The responsibility for checking incoming shipments should be delegated to one trustworthy person. He should be required to initial all invoices or other shipping advices and should be held responsible for the accuracy of all incoming shipments

It is important that the duties of *shipping clerk* be assigned to one responsible individual. He should be required to sign some evidence of withdrawal of merchandise from warehouse stock and be held personally responsible for the accurate filling of shipping orders. He should also furnish, to the person responsible for billing, an accurate initialed copy of a list of all merchandise included in each shipment

All warehouse stocks, either on the owner's premises or elsewhere in storage, should be in charge of some responsible employee designated as custodian. He should be responsible for the movement of goods in and out of stock. He should be personally accountable for any shortages. In addition, he should be required to maintain an inventory control of all goods, supplies, and equipment in warehouses or storerooms

No driver or delivery man should be allowed to put goods into storage or stock, or to remove goods from storage or stock, without the supervision of the receiving clerk, shipping clerk, or custodian

All drivers should be required to receipt for shipments received for delivery by them and to obtain receipts from the parties to whom such shipments are first directed, whether it be a railroad, express company, forwarding company, or customer

Drivers should be required to obtain receipts from receiving clerks and custodians of his own company to whom he delivers goods. Drivers should be held responsible for misdeliveries and should be required to return undelivered goods immediately to the shipping clerk and obtain a receipt or release

Valuable merchandise should never be left unattended while on docks or platforms of the warehouse, receiving room, or shipping room. It is dangerous to allow incoming shipment or outgoing load to stand overnight, whether in a garage or not

In addition to these precautions, you ought to check your purchasing department's operations against the following safeguards to eliminate the usual collusions in purchasing:

Consider the possibility of actual bribery of the person purchasing. It happens frequently. Your safeguard is a check on prices and a good receiving system

Maintain a continuous record of purchases both to facilitate subsequent orders and to permit your CPA to audit

Periodically have your CPA thoroughly review prices obtained

Be sure your buyer is familiar with the discounts in the trade

In order to eliminate questions, see that your orders are complete as to specifications, price, delivery date, shipping instructions, and terms of payment

Do this with your incoming invoices to minimize ordinary frauds:

Date and stamp the invoice

Provide a rubber stamp to be placed on the invoice so you will get all items checked: terms, prices, shipping quantities, quality, and everything else you need to be sure you are getting your money's worth

Be sure the invoice is checked by someone other than the person who ordered the material

And do this:

See that extensions are verified

Check on the receiving and the inspection to make sure that they are independent careful jobs and that you get what you expected to buy

Study the method of checking partial deliveries through comparing requisitions with invoices, to make sure that they are adequate

Make certain that the procedure is geared to secure all discounts
Investigate promptly all duplicate invoices
Investigate thoroughly all delinquent invoices
Reconcile your creditors' statements with your records and accounts. That often discloses trouble

How to control receipt of your materials to get what you pay for

You need to specify by item which materials are to be weighed, partly counted, or fully counted. Don't expect employees to be mind readers—tell them what has been purchased and how to check it. If left to their own devices, they may incur costs out of proportion on unimportant points.

Make sure a full report of receipt and inspection reaches you before you pay a bill. If some trouble occurs repeatedly, check if it is the fault of your supplier or of impractical specifications.

Be certain that your receiving process meets these simple rules to avoid fraud and loss:

Counts, weighs, and measures all incoming materials
Provides for independent inspection for quality
Maintains adequate records of receipts
Records receipt of all materials upon the copy of a purchase order or a receiving report
Checks freight and transportation charges, and checks whether these are to be charged back to suppliers
Checks all freight bills for classification and rates, and against freight allowances
Tabulates results of inspections to inform you of the reliability of suppliers
Ensures that the receiving clerks do not conduct negotiations with suppliers about adjustments, rejections, etc.

Get your CPA to check your receiving records to see if they are subject to alteration by anyone—particularly your purchasing people. Study the possibility of any collusion between purchasing agents and the receiving sources.

Locate your receiving department properly if you hope to cut costs. Give consideration to transportation facilities for deliveries if you can reduce rehandling in transferring to stores as much as possible—especially of heavy materials that are going directly to production departments.

Make the inspection in your receiving junction a primary responsibility. Make someone definitely responsible for checking the quantity and quality of material.

If a laboratory test is required, consider the economy of securing the necessary equipment
If extremely technical inspection is required of heavy materials, possibly

arrange for inspection at supplier's plant either just before shipment or while in process

How to plan for good inventory control

The small businessman always needs good inventory control. Stocks of live items do not remain stationary. The bin which is amply full today can be dangerously low a few days hence.

Perpetual inventory control arranges for practically automatic reordering. This system determines the maximum stock which should be on hand or on order at any one time and the minimum amount below which stocks cannot, with safety, be allowed to drop. Between these extremes is a reordering point. One easy way to control inventories is—

Set up an inventory card in the office, place it in the supply bin, or tack it on the wall nearby

On it show the maximum and minimum stock figures, the reordering point, the amount to reorder each time, and date of each order placed but not yet received

Carry running totals of orders received and of removals from the bin or rack so as to show, with reasonable accuracy, the stock on hand

Two or more times a year, check the card total against the actual count for all stock items

Make occasional spot checks (a few scattered items at a time) in between regular inventory periods to make sure that employees are noting removals on the cards and that smaller items are not disappearing

Make certain that you buy according to commonly understood specifications. Then on arrival of the wares, inspect them to see that you are getting just what you ordered

Check list of instructions for use of your perpetual inventory card

Describe the material as it should be entered on an order blank. This is for use in ordering. It also enables proper replacement of cards. Show here how long it takes a shipment to arrive, starting from the day the order leaves the shop. And do this:

Show maximum stock. This is the largest amount of stock estimated to be on hand and on order at any time. Change the figure as business increases or to reflect seasonal variations, when considerable

Show minimum stock. This is the danger point below which stocks on hand cannot be allowed to drop without taking a chance of running out completely

Show a reorder point. Considering time required to obtain, enter here the

amount of stock on hand that is to serve automatically as the point (time) to place a minimum replacement order. If properly timed, the order will arrive before the stock on hand reaches the minimum figure but not so soon that it will increase stocks on hand above the maximum desired

Show minimum ordering quantity. Show in this space the size of order to be placed under average conditions

Put down the date of each entry on the card. Start a new line whenever necessary. Have cards printed with plenty of lines—fold in half if unhandy

Make record of orders when placed

Make record of shipments when received

Remove material from stores to production only in exact quantities. Change these quantities as experience dictates

Show your balance on hand—the *actual* balance on hand. Make no entry in this column for materials on order. Keep this balance up to date after each receipt or withdrawal of material

If material has been allocated to a job scheduled for the near future, note it here so the reorder point can be stepped up, if advisable

Get your records set up for good control of the supplies already sent to factory. Be sure that that covers the entire method of bringing in supplies, taking them out, and periodically checking what you are supposed to have left

Recognize that even good records are easy to circumvent. You must guard supplies as you would guard cash to reduce losses, avoid normal, usual frauds, and discourage normal, usual employee collusions. Here are some aids:

Set up an independent check of material received in the storeroom

Actually count, weigh, and measure materials received, and check them carefully against purchase orders and purchase requisitions

Before entering them upon the records, be sure the records show existing balances at all times

Maintain a continuous check upon balances by the department

See that requisitions withdrawing materials from stores are carefully computed and entered

Have your CPA review your process to make certain that it is impossible for stores people to steal any materials

Require departments to furnish receipts for materials delivered to them by the storerooms

Study your operations to determine whether alteration of stores requisitions (to cover theft) is possible

Check the extensions upon requisitions occasionally. Sometimes frauds and errors are disclosed

- Prohibit general entrance to the storerooms
- Make sure that your stores are covered by the proper type of insurance
- Investigate to make sure you have the proper type of equipment, shelves, bins, hoppers, etc., to insure protection of supplies from theft
- Prevent losses resulting from faulty arrangement of supplies, dust, dirt, and so on
- Arrange for slow-moving stock to be brought to your attention regularly so that you can dispose of it with full control of the resulting receipts

How to take shop inventories for tax purposes

Tax considerations govern the way you take your inventory. The regulations require the use of an inventory in every case in which production, purchase, or sale of merchandise is an income-producing factor.

Any inventory that can be used under the best accounting practice, in a balance sheet showing your financial position, is all right for tax purposes.

Inventories should include all raw materials and supplies, as well as finished or partly finished goods. But they should not include—

- Raw materials and supplies which have not been acquired for sale, or which will not become a part of merchandise intended for sale
- Materials ordered by you for future delivery, title to which has not yet been transferred to you
- Assets of a capital nature, machinery, fixtures, land, buildings, accounts receivable, cash, or like assets
- Goods received on consignment
- Goods sold (also containers), title to which has passed to your customers

In inventorying your normal goods, a reasonably consistent basis of costing must be applied. Where you maintain perpetual inventories, inventory accounts are—

- Charged with the actual cost of the goods purchased or produced
- Credited with the value of goods used, transferred, or sold, calculated upon the basis of the actual cost of the goods acquired during the year (including the inventory at the beginning of the year)

The net value as shown by the accounts is accepted to be the cost of the goods on hand. But balances shown by perpetual inventories must be checked to physical inventories at reasonable intervals.

The method of inventorying some unusual items—not in the foregoing—is obtained from the following:

Operating supplies or property not intended to be sold. Not required to be

inventoried. You may treat it as a deferred charge to be deducted as used or consumed

Merchandise in hands of processor. Inventoried by owner when goods are to be returned in kind; for example, goods to be dyed. But when a new product is to be returned (for example, refined copper for ore, or flour for wheat), then it is an exchange—not inventoried

Goods under contract of sale but not yet segregated and applied to the contract. Include in inventory of seller. Exclude from inventory of buyer

Goods under a noncancellable contract of sale, segregated and applied to the contract. Charge to the buyer. He includes these in his inventory

Merchandise, title to which has passed to the buyer (title passes, usually, when the parties intend it to pass; local state law should be consulted). Exclude from seller's inventory. Include in buyer's inventory even if goods are in transit or buyer does not have physical possession.

Goods, including shipping charges, sent c.o.d. Include in inventory of seller until payment and delivery are made

Goods shipped on approval. Include in seller's inventory until they are accepted

Merchandise sold and shipped according to contract but *refused by the buyer* because of a price decline. Do not include in seller's inventory

Goods sold by sample, subject to inspection and rejection within a given time. Include in inventory of seller if promptly rejected by buyer, even though the goods are not returned before the end of the year

Goods rejected because of defects. Include in seller's inventory, not in buyer's, if rejection is timely

Goods sold and found unsuitable by buyer, then resold to him in the following year with concessions from the original price. Exclude from seller's inventory from the first year when originally sold

Goods shipped on consignment. Include in seller's inventory until consignee sells them

How to inventory for tax purposes

Cost, and cost or market, whichever is lower, are approved as proper methods for inventorying. To find cost, you may use the "first-in–first-out" or the "last-in–first-out" methods. How each of these work is illustrated by the following.

Assume that the inventory at beginning of year was composed of 1,000 units which cost $2 each. They had a market value of $2 on that date. Purchases in the year were 2,000 units at $4. Sales in the year were 1,500 units. Inventory at end of year was 1,500 units. The market value was then $5. The effect upon cost of sales by the various methods of inventorying is outlined in the following table.

Method	Inventory at end of year is computed—	Therefore cost of goods sold in year is—
Cost:		
First-in–first-out	1,500 at $4	1,000 at $2 500 at $4
Last-in–first-out	1,000 at $2 500 at $4	1,500 at $4
Cost or market, whichever is lower...	1,500 at $4	1,000 at $2 500 at $4

What does cost mean? In the case of merchandise on hand at the beginning of the year, it is the inventory price of such goods. In other cases it is as follows:

Merchandise purchased since the beginning of the year—invoice price less trade or other discounts, except strictly cash discounts. To net invoice price, add transportation or other necessary charges incurred in acquiring possession of the goods

Merchandise produced since the beginning of the year—the sum of: cost of raw materials and supplies entering into or consumed in connection with the product; direct labor; indirect expenses necessary for the production of the particular article, including probably a reasonable proportion of management expenses, but not including any cost of selling

Any industry where usual rules for computation of cost of production are inapplicable—costs may be based upon an established trade practice of the particular industry

Miners and manufacturers who, by a single process, or uniform series of processes, derive a produce of two or more kinds, sizes, or grades—you allocate costs to each kind, size, or grade of product, which in the aggregate will absorb the total cost of production. Cost must bear a reasonable relation to the respective selling values of the different kinds, sizes, or grades of product

What does market mean? In ordinary circumstances, it is the current bid price prevailing at the date of the inventory for the same merchandise in the volume in which usually purchased. This rule applies to goods purchased and on hand, goods in process of manufacture, and finished goods on hand. It does not apply to goods for delivery upon noncancellable sales contracts, at fixed prices below the market. These can be inventoried at cost. Or you can use these rules:

If no open market exists or if quotations are nominal because of stagnant market conditions, use evidence of a fair market price at the date nearest

the inventory. Or use specific purchases or sales by you or others in reasonable volume and made in good faith. Or use compensation paid for cancellation of contracts for purchase commitments

Where prices are falling, market may be your sales price, less what it costs you to make the sale. Correctness of this method is found by your actual sales for a reasonable period before and after the date of the inventory

The use of "last-in–first-out" is not dependent upon character of a business. This method can be used:

For a class of goods as well as all your goods

For raw materials only, including the raw materials entering into goods in process and into finished goods

For only that phase in the manufacturing process where a product that is recognized generally as a saleable product is produced, as, for example, in the textile industry, where one phase of the process is the production of yarn

For any one raw material, when two or more raw materials enter into the composition of the finished product, for example, in the case of cotton and rayon yarn

When should you use the LIFO (last-in–first-out) method of inventory valuation? Not if prices are likely to decline in the years ahead, as may well happen when demand is satiated and production catches up. The LIFO method would leave you with high inventory valuations of the items acquired at high prices during the period of shortages.

If you selected the LIFO method of valuing your inventory during prior years, you should check your present position. In a market of declining prices this method will be to your disadvantage. As soon as the prices drop below the level of costs when this method was adopted, you might apply to the commissioner for permission to change. It will then be to your advantage to change to FIFO (first-in–first-out).

If you are a manufacturer and have included your entire factory overhead in costs, it may be advisable to apply for permission to change your method of valuation.

Many businesses do not include overhead in inventory costs. And a serious question has arisen as to whether many costs like salaries, taxes, interest, rent, or other expenses provided for as specific deductions on the face of a tax return can ever be included in inventory costs. The Treasury holds that Federal import duties are deductible only (as expenses) and may not be considered in determining cost of inventories for Federal income-tax purposes. Rent, repairs, taxes, depreciation, and amortization of emergency facilities are likewise deductible only (as expenses) and may not be considered in determining cost of inventories for Federal income-tax purposes.

Ordinarily, rent, repairs, taxes, depreciation, and other factory overhead

expenses are charged to the cost of production. This conforms to accepted principles of cost accounting. If the Treasury ruling is followed literally, charging to production is not correct.

Once you elect an inventory method, it must be applied in all later years unless another method is authorized by the commissioner. Here are the rules:

Application to change must be filed within 90 days after the *beginning of the year* for which the change is to be effective. With your application, you must show the classes of items that will be treated differently under the two methods and the amounts that will be duplicated or omitted by the change

You will not get permission to change until you agree to terms that will be given you. That may involve adjustment of prior years' returns and payment of taxes for some prior years. State your case to the Treasury and they will advise you fully

An exception is made with the "last-in–first-out" basis. Your application to adopt this method is merely filed with the return for the year in which it is first to be used. You must give detailed information of beginning and closing inventories for that first year and the beginning inventory of the preceding year. Manufacturers must, in addition, show details of their cost computations

Further, you may be required to make adjustments to inventories of prior years. The Treasury can impose these conditions in order that your true income will be clearly reflected for all the years involved. Once this method is adopted, you must use it in all later years unless the commissioner requires or authorizes you to use another method. Permission to discontinue it may be granted on your application to change under the rules described above

How to use inventory hedges advantageously

A loss from a futures hedging transaction is an ordinary expense and a full tax deduction. But not all futures contracts are hedges. To get the full deduction, the transaction must be a purchase or sale for future delivery, intended to protect against price fluctuations.

This is a form of price insurance to avoid the risk of changes in the price of a commodity. The basic principle of hedging is the maintenance of an even or balanced market position.

If you buy futures regularly as protection against price fluctuations of the identical commodity used in your business and you intend to take deliveries, then any loss you suffer is fully deductible on your tax return. This is considered to be a true hedge—a form of price insurance.

In other cases, your loss is a capital loss—like that from the sale of securities. The transaction is regarded as a form of speculation.

You may buy a "futures contract" calling for delivery of merchandise at a future date. On the delivery date the price of this merchandise may have fallen. It may be wise to accept delivery. The loss suffered upon the sale of the merchandise will then be an ordinary loss. If, instead of accepting delivery, the "futures contract" is sold at a loss, it may be a capital loss. And that may be of no use to you.

Scientific cost keeping is necessary for your survival

Your CPA can build you an efficient system—perhaps by use of methods of costing already tested in your industry. Good business requires you to discard or revise your present system if it does not give you what is outlined here.

Normally a good system should furnish the accurate cost of jobs, parts, articles, and assemblies. Also, it should—

- Compare present costs with previous experience or set standards
- Show present costs as compared with those when the price level was set
- Analyze the operating efficiency by: furnishing regular comparative data; detecting increases in elements of cost
- Allocate costs to precise units by distributing overhead to production centers or jobs in rational manner

In designing a system, talk to your CPA about the advantages of complete standard costing. In that system—

- You set cost objectives for materials, man-hours, machine-hours, etc., that are reasonably obtainable. You then periodically and promptly report exceptions in practice
- You expose departures from standards. This study of variances is worth while if you do something; for example—
  - Get your supervisors to study and get at the causes and prevent excesses. Ask them for reports on variances
  - Get everybody's hearty cooperation all along the line, by providing incentives as rewards for better-than-normal performance

Design cost reports in the language of the men who use them. Then analyze them and periodically go over them with supervisors to get their enthusiastic cooperation to attain or beat the standard.

- Develop a system of standards for reporting every change, good or bad, to all supervisors
- Produce automatic reports revealing increased costs caused by—
  - Plant idleness or higher material prices
  - Reduced production, and thus greater unit overhead cost
  - Increased labor costs with scale changes
  - New transportation costs arising from reroutings to get delivery

The analysis of labor cost should be a fundamental part of your cost keeping. Build a system that will: help to cut payroll frauds; be of use in cost compilation; be the basis to furnish a daily record of plant efficiency.

Daily labor cost reports give you a method of production analysis for foremen as well as for executives. Have them give you, for each man, each operating center, and each department—

Cost and statistics of production of the operators
Cost and time lost by operators, plus explanation
Comparisons of labor time, dollar cost, and production with the standards created, plus explanation of variations

The same record keeping should furnish the data for necessary financial and cost records. It can determine the wages due each man as a check against the regular payroll records. It can be a full basis for cost records.

Make sure your plant payroll process guards against *payroll errors and frauds*. Some aids are—

Maintain a historical record of each employee, the date of employment, starting salary, department, and date of discharge. In this record, allow for salary changes and full approvals. Get your CPA to check this to payments
If you can, pay by check to eliminate risk and to save time in making up the payroll
If you can, pay on a semimonthly basis (to diminish risk)
Get your CPA to make a periodic physical check of employees on the payroll—get this to periodically supervise the actual distribution of salaries or wages. You need to guard against "dummies" receiving wages
Make it a point to investigate all unclaimed salaries or wages
Obtain receipts for all payment made in cash
Get your CPA to check mathematical computations of payrolls. Someone other than the paymaster should check his figures
Study the safeguards that time clocks offer. If you have clocks, audit them for possible duplicate cards
Be sure to check timecards against time charged to jobs on cost assemblies

An analysis of material costs is also essential to a good system. You should gather material costs by jobs, processes, departments, etc., as basis for analysis and comparison. Here, seek information about high costs, waste, and spoilage exceeding the standard, resulting from—

Changes in costs owing to an increase or decrease in the price of materials
Errors of individual operators
Faulty material or machines
Faulty operating conditions
Errors in planning or direction
Errors in design
Sabotage or theft

Make sure your cost records also produce detailed studies of machines and departments. Adopt a form that will show clearly all variations from fair

standards. They should show the periodic production accomplished, comparisons with the standards, and the reason for all discrepancies.

These records should constantly analyze the cost of man and machine idleness so as to give—

- Service problems for which the employee is not responsible
- If lack of work causes idleness, the basis to investigate your planning, routing, dispatching, or scheduling
- The losses due to unavailability of materials, tools, or equipment. That means wrong planning, poor stores control, or bad scheduling
- The waiting for setup, absence of instructions, damage to job, power off, or a machine needing repairs. These call for speedy correction
- A general report on idleness

Good management finds labor cost reduction in these recorded studies. But you need to sell your foremen and key men on their use to improve costs.

That means you must train them to realize that cost improvements don't just happen. They must be worked out. You can assist them if you create a regular routine under which they can study costs.

In setting up your cost system, get your CPA to explain its design and purpose to those who will gather the cost data. Particularly, get him to explain why—

- Cost records tie in rigidly to the control over stores and inventories. This usually means you must keep perpetual inventory records. And check them against physical inventories
- Cost records are unreliable without control of materials. You must insist upon a tie-in to control the receipt, storage, and economical use of materials and supplies
- Cost records are designed to balance with the payroll records. At the same time they furnish data for the cost compilations as well as payroll tax data
- Cost records are tied into plant ledger showing the inventory of individual equipment cost. This is important to set up a regular system of reporting maintenance costs, inspection costs, adjustment costs, repair costs, and other costs to keep the machines in good condition
- Cost records must be interlocked with general ledger and financial controls, so as to make sure the cost records are correct

How best to organize for your plant sales

You need to know the market for your product, the channels of distribution which you will use, the effects of competition, and the price policies which will govern your operation. Then it is possible to outline a sales and promotion program to fit your specific needs.

Too much stress cannot be laid upon the wisdom of tailoring your sales, promotional, and advertising efforts to your product.

It is impossible to generalize on this subject. Only a careful examination and evaluation of all the important facts will provide the proper answer. But what is all-important is that: you have a clear idea of the problems involved; every effort be made to make your selling program conform to the product.

How to find your best market for sales

Your first step in organization for selling is to find your market. *You need research to do that.*

How do you use qualified individuals to find the reputation of your merchandise among wholesalers, jobbers, retailers, and users? This research also should give you—

Up-to-date data on competitors' products, sales policies, sales methods, trade reputation, volume
Suggestions for bettering your product, sales program, advertising, service, operating methods
Opportunities to inaugurate services or policies to create new buyers or markets, strengthen the loyalty of present customers, improve your local or national prestige
Opportunities to be leaders, rather than followers, in meeting changing conditions

How do you study the most advantageous distribution setup. That is to give you the advantages and disadvantages of the following types of distribution for which your merchandise may be qualified:

Factory-owned branches—with warehouse, without warehouse
Manufacturers' agents—buying and selling on own account—on commission, without inventory
Wholesalers, jobbers, brokers—exclusive, nonexclusive
Retail outlets solicited direct—exclusive, nonexclusive
Door-to-door salesmen
Mail-order promotion without sales force
Territorial manufacturing-and-sales franchises
Through mail-order houses
Through private brand merchandisers—wholesalers and jobbers, chains, cooperatives, department stores, supermarkets, manufacturers who operate retail outlets selling related merchandise, and smaller retailers, including specialty shops
Through a single, exclusive sales agency
Through neighborhood agents and community organizations
To premium and novelty houses

Through United States export houses and/or foreign importing firms
Any other procedures successfully employed for comparable merchandise

If your products are moving to the consumer, how do you study the retail outlets you can best use? That involves considering the possibilities of all retail outlets handling a wide variety of merchandise, such as—

Auto-supply stores
Building-supply stores and yards
College cooperatives
Company stores
Department stores
Drugstores
Electrical and radio shops
Farmers' cooperatives
Five-and-tens
Furniture stores and installment houses
Garages and superservice stations
Gift shops
Groceries, supermarkets, and delicatessens
Hardware stores
Mail-order houses
Men's furnishings stores
Mill-supply houses
Newsstands and tobacconists
Office-supply and school stores
Photographic stores
Ship chandlers
Sporting-goods stores
Variety stores

If you can find these things, you can then plan the type of sales representative required; you also can find the number of sales representatives you need, where to look for them, what training will be necessary, and where they should be located.

All this takes sales research.

Do a selling research job—it will pay off handsomely

Although most manufacturers carry on some marketing research, small companies lag far behind. They overlook the benefits to be gained. Three out of four small manufacturers do no marketing research. Yet only by undertaking an intensive study of its sales potentials can the small company build its competitive position in a buyers' market.

Research activities seek these guideposts:

Sales opportunities, including the figuring of sales potentials, forecasting of sales, and setting of sales quotas
Sales, through analysis of sales statistics and measurement of salesmen's performance
Distribution methods, involving study of standards for distributors and retailers
Products, including testing of such factors as product preference, product use, and package design
Advertising, appraised with particular reference to the effectiveness of advertising in selling goods

Price, demand, and analysis of business and industry trends
Consumer preferences, appraised through consumer surveys

Higher sales, higher dollar profits, and lower distribution costs are some of the benefits the small manufacturer may derive from marketing research. Only research reveals—

How to make the best use of established outlets and how to satisfy consumer demand

Direction that your sales, advertising, and promotion efforts should take. By study of sales potentials, the manufacturer may discover how to arrange salesmen's territories, delivery policies, and other realignments. He may be led to abandon ideas for routes in sparsely populated low-consumption areas

Price-volume relationships—these will in turn help to reduce sales resistance

Analysis of distribution costs to reveal unprofitable sections or areas, because of large freight and delivery costs—or high selling and advertising costs in ratio to the sales volume for these areas

Study of the product demand to determine the reasons why products do not sell, the sales appeal and features desired by users, and the most important sales procedures

Since marketing research is broad in character and differs greatly by products and by companies, there is no single approach suitable for all industries.

For this reason a list of sources covering procedures is desirable. They can be obtained free of charge by writing to the Department of Commerce. Using these as a base, the manufacturer can formulate his plans to conduct some market research work through either a company executive, a market research department, or a professional organization.

Planning a productive promotion and advertising program

Intelligent planning for promotion and advertising consists of a lot more than merely appropriating a sum of money to be spent. There is a simple way to set up an advertising and promotion program and to determine how much money should be invested in it. You start with a definite objective and then assign each part of the "fighting forces" to the task they can do best. For example—

One of your first objectives is to get your product in the hands of a sufficient number of outlets

You must know how many retailers there are, where they are located, and their size

You must have a pretty good idea of how many retailers you will have to sell in order to have adequate retail distribution

You must know, too, the extent of your "ground forces" (your own salesmen, and the salesmen of wholesalers and distributors) available to make the sales

If you know these, you can gauge the promotion and advertising support that these "ground forces" will need in order to do their job most effectively, quickly, and economically. You are then in a position to formulate your promotion and advertising campaign to accomplish your objective. You may decide that advertising in the trade papers reaching these retailers, sending out direct mail, exhibiting at trade shows, and similar activities are called for.

Having laid out the plan of campaign, the necessary budget almost sets itself. Instead of picking an arbitrary promotion and advertising budget out of the air, you start at the other end, determining the objective first, then detailing the steps involved, and finally estimating the cost. Of course, you will probably find that the "ideal" campaign will cost more than you are able to spend and that a compromise must be reached. You must then re-evaluate each item in your list, cut or trim the least important, and finally arrive at a program within your financial means and reasonable from the standpoint of possible returns, but still adequate to perform the specific task or tasks which you want performed.

Operating in this manner, with each step in the promotional and advertising operation given a definite objective, this phase of the company operation becomes as scientific and as amenable to evaluation of results achieved as your sales or your production operations.

It must be borne in mind, however, that initial costs for selling, advertising, and promotion will probably be extraordinarily high in introducing a new product. For products which have fast turnover and are bought over and over again, it is not unusual for promotion expense during the introductory period to be as high as, or even higher than, the total sales volume. And even in the case of consumer capital goods which have a long life, the cost of introduction to the consumer market can reasonably be expected to be very high.

How high these costs should be, and how long these extraordinary costs are justified, are matters for individual determination in each case, but they can be determined, and the potential value of each new user can also be determined. On one product selling for \$1, it may be well worth while to spend \$2 or more to gain a single new customer; on another \$1 product, it may be unprofitable to spend as much as 50 cents to gain acceptance in the introductory period. Use this list to help you find what kind of promotion you will use:

Have you an advertising agency connection which will be able to handle the new product?

Have you decided on the details of the advertising program? What advertising and promotional support, if any, will be given locally to distributors?

What kind of sales force is required?

- What type of salesmen will be needed?
- Will the men require special or technical training?
- Will the entire sales force work out of the home office?

Are you familiar with the general sales promotion practices followed by distributors in reselling in this field?

Are you familiar with the sales promotion and advertising practices of other manufacturers in this field?

Have you determined what type and how much sales promotional assistance you will give your own salesman?

Are you planning an organized publicity campaign (as distinguished from advertising) to help make your new product familiar to the public?

Will your promotion and advertising budget be determined on the basis of—

- The cost of attaining a definite objective?
- A certain percentage of estimated sales?
- An arbitrary sum?
- Some other system?

Do you know how many salesmen will be needed?

- Have you determined their compensation?
- Have you worked out territory assignment and routing through the field?
- Have you given special thought to the "missionary" selling they may have to do for introductory purposes?

Who will bear the costs of this local advertising and promotional support, and in what proportion?

How will you control such assistance so as to make certain that it is used most efficiently for the benefit of the product?

What approach will you use in advertising your product?

What to study in developing a new product

Manufacturers intending to introduce a new consumer product need to study their production and manufacturing factors carefully.

They know what materials they will need, where they can be purchased, and how much they will cost; they know whether or not an adequate labor supply is available; and whether their plant is efficiently equipped to handle the product.

This section is concerned with markets, distribution, merchandising, and selling to make the product successful.

A manufacturer who introduces a new product—no matter how good or

how useful it may be—without having clearly thought out the course which he will follow to move that product from his factory into the hands of the ultimate consumer, can find himself in very serious difficulties.

The following Department of Commerce check list permits analysis of an entire marketing procedure. When you get through with it, you have charted your course. You know the users, how to get to them, and your competition, and you know how much more thought or investigation will be required of you before you can be sure that your product will be launched into the competitive arena with the best possible chance of being successful. When this check has been completed, you will have at your finger tips a brief "control sheet" which will show you exactly how well you have equipped your product for its competitive battle in the market place. And you will know exactly what further thought and study you must devote to the problem.

1. What consumers will use the product?
   - What types of consumers are they? Housewives, school children, farmers, salesmen, mechanics, animals, or what?
   - How many potential customers are there? What factors cut down the size of the total market?
   - How many live in sections of the country where they will not use the product?
   - How many are in the wrong age group to use the product?
   - How many are likely to be poor prospects because your product is too expensive or too cheap for them? (To what income classes will your product appeal?)
   - How many are likely to be out of the market because they already have similar products giving satisfactory service?
   - How many live in such a manner that they cannot use the product? (For example, if you live in an apartment, you are not a good prospect for a lawn mower.)
   - How many would not be prospects for religious or racial reasons?
   - Are there any other market-limiting factors peculiar to your product?
   - How many prospects are left for your product?
2. Where do the potential customers live?
   - Are they scattered throughout the country? Are they limited to particular sections or states?
   - What size community do they live in, and what are their buying habits? Do they live in cities and buy at neighborhood stores? Or at downtown stores? Or do they live in small towns and on farms and buy in town? Or by mail?
   - Are there climatic or employment factors in their location that you should investigate? (For example, is your product designed only for cold climates or only for workers in steel mills?)

3. Will the product meet the requirements of your logical prospects?
   - Will its price compare favorably with that of existing products of its kind and with that of similar products which may be introduced shortly?
   - What is the present consumption of products of this type? Is the market for this product likely to change in size during the next 2, 5, or 10 years?
   - How often will consumers buy this product? (Is it a durable goods item which will last several years or something in everyday use which needs replacing every few days or weeks?)
   - Will the product sell evenly throughout the year or will the bulk of the sales be concentrated at certain seasons?
   - What features of the product appeal most to consumers? (Rank in the order of importance.) Is it cost of operation, durability, ease of repair, price, service and maintenance, style, trade-in value, or other features?
   - What are consumer prejudices, if any, in regard to: cost of operation? Durability? Ease of repair? Price? Service and maintenance? Style? Trade-in value? Other factors?
4. How are products of this kind usually bought by consumers?
   - Are they bought for cash? On open account credit? On a time-payment plan? On an installed basis? With the expectation of a service guarantee?
   - If they are bought on an installed basis, will the most of installation be included in the price of the product? Or is installation of the product (*e.g.*, rewiring for an electric range) additional expense for the consumer?
   - Does your product have any possibilities for industrial use? Through what channel or channels are consumers accustomed to buying products of this kind? From retail stores? By mail from catalogues? From house-to-house salesmen or demonstrators? From services outlets (*e.g.*, plumbers, auto or radio repair shops)? From other sources (*e.g.*, direct from ads, book clubs, or cooperatives)?
5. Put this question to yourself and your friends and associates: "If *you* were going to buy a product like this, from what outlets would you prefer to make your purchase?"
   - If the method by which you expect to get the product into consumers' hands is not the same as the preferences stated above, what is the reason for the difference? Is there difficulty in securing dealers? Does the product not follow pattern used for other products in the line? Does it require too much time to secure market coverage? Is competition too great? Any other reason?
   - Are the reasons important enough to justify your decision to market your product in a way that does not coincide with the way consumers prefer to buy products of this kind?
   - Assuming that you will distribute your product through retailers,

what kind of retail stores will sell it (*e.g.*, grocers, department stores, hardware stores, gift shops, or others)?

How much do you know about the operations of this type of retailer? How many such stores are there? Where are they located?

What per cent of total sales volume in this field is done by independent stores? By corporate chains? By voluntary chains? By manufacturer-owned stores? By consumer cooperatives? By others?

On what basis do your competitors usually sell products of this kind to retailers? Exclusive franchise? Selected distribution? General distribution?

If on an exclusive basis, do dealers expect to be protected against competition from other retail outlets in their town or neighborhood?

Can you sell your product through both independent and chain stores?

At what seasons of the year will retailers be most likely to buy your product?

What is the best and easiest method of selling to these retailers? Through established wholesalers or jobbers? Through exclusive distributors? Through your own factory-controlled sales force? Through a combination of the above? By other methods?

How many wholesalers, jobbers, or other intermediate distributing organizations are there which can logically handle your product?

What is the best and easiest method of selling to them? Through salesmen, demonstrators, or technical personnel working out of the factory? Through branch offices of the factory? Through brokers, sales agents, or others?

Do you know the wholesale trade practices or discounts, allowances, billings, credit, and warehousing which you will have to meet?

If products like yours are usually installed or have a service guarantee, will you conform?

If so, have you arranged for the service and installation through the distributive channels?

6. What competition will your product face?

What is the reputation of leading competitive firms? Leading competitive brands?

Are manufacturers likely to enter the field with products similar to yours? If so, what is their reputation?

Can any competitor bring out a seriously competitive item quickly? Will marketing your product cause competitors to give you additional or keener competition?

Can your product compete favorably with similar products already on the market as to price? As to quality? As to style? As to service?

To what degree does nonproduct competition exist for your item (*e.g.*, commercial laundries for washing machines)?

Aids in marketing your new product

Businessmen have long been familiar with the aids of the Department of Commerce in planning marketing and sales programs for new products. Less known perhaps are the Department's listings of available patents for new-product development. Write for them.

There are several other ways in which the Department can be helpful to manufacturers concerned with new-product development problems. It often can help manufacturers to find ideas, as well as to save dollars, when designing new products. Other sources of government information are these:

1. *Register of patents available for licensing or sale.* Manufacturers or individuals who have patents they wish to sell or license may request the U. S. Patent Office to place such patents on the register of patents available for licensing or sale. (Many corporations have large numbers of patents on the register—some several thousand.) This reservoir is a fertile source of new-product ideas. Some of those listed may be used on payment of a royalty to the owners; others may be purchased outright.
2. *Government-owned patents.* The Federal government carries on vast research programs in the field of nearly every industry. As a result, the government develops and patents many processes and products, which are usually available to manufacturers on nonexclusive royalty-free licenses. These government-owned patents may yield usable new-product ideas as well as useful information on research and development work already undertaken on products and processes. The Patent Office prepares periodic lists of such government-owned patents, which are available free from the Patent Office in Washington, D.C.
3. *Dedicated patents.* Many business firms and individuals have dedicated patents to the public. When a patent is so dedicated, the donor divests himself of all ownership in and control over the invention. Hence, no license to make, use, or sell is required; no royalty need be paid; and no formality is necessary to make full use of the patent. Information on dedicated patents may be obtained by writing to the Patent Office in Washington, D.C.
4. *Testing, simplified practice, and commercial standards data.* Previous research, testing, and standardization activities of the National Bureau of Standards also can be helpful to some manufacturers, commercial laboratories, and product engineers in connection with the design and development of certain new products. For example, it may be advisable for a manufacturer to check and see if any simplified practice recommendations or commercial standards are operating in the field with which he is concerned. Lists of commercial standards and simplified practice recommendations are available from the National Bureau of Standards in Washington, D.C.

How to set the price for your product for greatest profits

The price you establish for your product may be the pivot on which the success of your marketing efforts will turn. Every step to a definite and concrete price policy should be carefully considered:

It is obvious that retail prices *must* be in line with competition for the same quality, service, or styling
Discounts and allowances must be in line with the established practices in the field
A thorough knowledge of trade practices and customs in the field served by the product is a first essential in the establishment of a workable pricing policy
In attempting to enter a new field, or to enter an old field with a new product, you will find it necessary to set up a schedule of discounts and allowances to wholesalers, retailers, and others which will make it attractive to them to add your line
It should also be borne in mind that many a manufacturer has foundered on the rocks of a system of distributive discounts which has been so large that it has defeated its own purpose

Unless resale price maintenance is practiced (and this practice, now possible under the laws of many states, should be carefully investigated), an overgenerous scale of discounts can often lead to price-cutting practices under which it becomes virtually impossible for anyone to make any money on your product. If this occurs, the product becomes a commercial football, with results that can be disastrous. The most important items, then, in setting a price policy may be said to be these:

Be certain that your scale of prices, discounts, and allowances is, at least, in line with long-standing trade practices
Be certain that discounts and allowances are such that each factor in the distributive system, all the way from factory to retailer, not only can, but *should* make a satisfactory profit
Be certain that a proper relation exists between all of the distributive elements who may handle your product, so that no units or groups in your distributive setup will have so large a price advantage over other units that it is impossible for some wholesalers or retailers to compete successfully with others

Incidentally, it is well to bear in mind, when setting up your price policy, that clearly defined Federal laws prohibit the establishment of any price policy which discriminates between individual buyers. You can, of course, provide larger discounts for larger buyers, give special concessions for merchandising service, etc. But in each case these special discounts and con-

cessions must be available on an equal basis to all buyers who meet the specifications you set up.

You should also remember that a price policy embraces more than prices, discounts and allowances. It embraces everything that goes into the establishment of a true price, including especially such items as credit and collection policies; whether goods are sold f.o.b. factory or on a delivered basis; consignment policies; policy on returned goods, cancellation of orders; and credit for damaged or unsatisfactory goods. Use this check list to find where you stand:

Do you know, in general, what your price policy will be on this product?
Have you determined what classes of customers will be entitled to discounts and allowances?
Have you determined the schedule of discounts and allowances to:
- Exclusive distributors?
- Wholesalers?
- Retailers?
- Other distributors?

After considering trade custom in the field for your product, have you determined policy with respect to—
- Pricing point (*e.g.,* f.o.b. factory; local warehouse; delivered)?
- Credit?
- Credit facilities?
- Collections?
- Returned goods?
- Consignment?
- Order cancellation?
- Damaged or unsatisfactory goods?
- Use of minimum retail prices through price maintenance agreements?

Have you considered insurance and transportation costs, as well as costs of manufacture and selling, in determining your price?

Know the laws you face in selling your product

There are a number of very important questions for which you need a lawyer's help before going ahead with selling a product. They deal primarily with patents and trade-marks, legislation affecting marketing, taxes, etc.

You are probably reasonably familiar with patent and trade-mark legislation. You must make certain that you do not infringe on any other manufacturer's rights in this field. But perhaps the most important legal difficulties to avoid are those which have to do with marketing. These are likely to be less familiar to you, because in so many instances they differ greatly from state to state and even from locality to locality. Consider these:

In the national field, the principal statutes and regulations by which the marketer in interstate commerce must abide are antitrust laws, including the Robinson-Patman and Miller-Tydings Acts, the Federal Food, Drug, and Cosmetic Act, and the Federal Trade Commission Act. It will pay you well to have your legal counsel examine your product, your labeling and advertising, your sales agreements, price policies, etc., in the light of these statutes, and state fair-trade and pure-food laws.

In the state and local field, laws, ordinances, and regulations which circumscribe the field of operation are too numerous to detail, but mention of a few of them will give you an idea of the possible difficulties which may be encountered unless great care is taken.

Premiums and certain types of contests in connection with the sale of merchandise, while legal in most states, are prohibited in some, and material dealing with such premiums or contests must be kept out of the prohibited states, or must contain a specific disclaimer, saying that the premium or contest offer is not good in such states.

In the case of alcoholic beverages and a number of other products, state laws vary widely on what may be said and shown in advertising and display material; and in many states, certain types of products, such as drug products, may be sold only in certain types of retail outlets.

A substantial number of cities throughout the country have adopted ordinances circumscribing the activities of house-to-house canvassers and frequently requiring a license. In other states, restrictive laws have been passed which may tend to cut down or eliminate sales of out-of-state products competing with dominant local industries.

We are all familiar with the fact that health laws, building codes, and sanitary codes are in operation in most, if not all, cities. In many instances, these laws prohibit the use of certain types of products in construction or in homes.

Perhaps you should visit your lawyer and go over this kind of check ist with him:

Is your product patentable?

Is its trade-mark protected?

Are all claims to royalties or other indemnities settled?

Do royalties limit the market for the product?

Is there anything in the product, its labeling or advertising which may cause you to become involved in a possible violation of a Federal, state, or local statute or ordinance?

Is the nature of the product such that regulations, trade agreements, etc , may restrict or prohibit its sales in certain areas?

Is there anything in pricing policies, trade practices, or selling setup which might involve a violation of Federal, state, or local statutes or ordinances?

Have local licensing and tax problems been considered?

What are the relative merits of the various freight carriers available for moving the product to the market?

Will it be desirable to insure the product while in transit to the market?

Are there any labor or union regulations which might affect the manufacture or distribution of the product?

Are there other problems, peculiar to your product, that should be considered?

You must avoid terms of sale that are discriminating

Most sellers know the law forbids price discrimination if it will injure competition. Special sales terms that amount to price reductions, or price increases, should be quoted to all purchasers on an equitable and consistent basis. Special terms may be granted in good faith, where necessary to meet competition, but shaded prices or discounts should normally be applied uniformly to all competing customers who purchase the same product in the same period of time.

Services, or allowances for services, should also be made available to all purchasers on proportionally equal terms.

If you quote terms of this type, ask your lawyer if you can protect yourself by: informing all buyers of your terms; holding special offers open for a reasonable period of time.

What about rebates in case of market decline? A seller is free to give a buyer a guarantee against a price decline. That is—he may promise a customer a rebate equivalent to whatever price reduction is made between the date on which the buyer places an order and any specified future date—frequently the delivery date.

He will meet requirements, if he gives the same terms to all customers who place orders on a single date and have rebates computed as of a single future date. Any shift in the initial date, or the rebate date, justifies a change in terms—provided changes in the seller's costs or in market conditions have occurred.

Example 1. On Nov. 1, *X* takes identical orders from *A* and from *B* for delivery on Mar. 1 of the following year. He should not give *A* a guarantee against a price decline and then refuse to give the same guarantee to *B,* if there is any possibility of injury to competition.

Example 2. On Nov. 1, *X* takes an order from *A* for delivery on Mar. 1 of the following year. He gives him a guarantee against a price decline. On Dec. 1, he takes an identical order from *B* for delivery on Mar. 1. If conditions have changed, and he is no longer giving guarantees to any of his customers, he may refuse to give *B* a guarantee similar to *A*'s, even though both customers will take delivery on the same date.

What about future delivery contracts? A price quoted for future delivery need not be the same as a price quoted for immediate delivery. This is so because the law does not prevent changes in price based on changes in market conditions.

A seller may, for example, take an order from a customer for delivery one or two months ahead, at either more or less than the price prevailing on the day when the order is placed. On the other hand, if he quotes different prices to different purchasers who place orders for the same amount of the same product for delivery on the same advance date, he runs the risk of violating the law.

Example. On Nov. 1, *X* charges *A* $1 for an item for delivery on Dec. 15; he charges *B* 75 cents for the same item for delivery on Mar. 1. There is nothing in the law to forbid this. He would, however, risk violation of the law if, on Nov. 1, he charged *A* $1 for delivery on Mar. 1 and *B* 75 cents for delivery on the same date. Safety hinges on offering, on the same day, the same prices for deliveries on the same future date.

What about options for future purchase? A seller may give a buyer an option to purchase a given amount of an item at any time up to a given future date, at the price prevailing on an earlier date.

It is, of course, true that a buyer who does not have such an option may be paying a different price, when purchasing on the same date as the buyer who has the option. This fact will, however, not result in violation of the law if all similar buyers have had the same rights and opportunities to enter into a like option.

Example. The market price for an item is $12 per dozen. *A* obtains an option to purchase 100 dozen at that price, for delivery during the following 6 months. Exercise of this option will not involve danger of violating the law, even if the market price rises above $12 per dozen during the period, if similar buyers have had a fair opportunity to acquire an option on the same terms as *A*.

What about return privileges? A seller is, in general, free to permit buyers to return merchandise under any conditions he may care to establish:

- He may permit return of damaged or imperfect items
- He may permit returns if the buyer receives the goods after a specified delivery date
- He may even permit the buyer to keep a product for several months and then send it back, if the product cannot be disposed of at a normal markup

Unless return privileges are made available to all buyers on identical terms, violation of the law may occur.

Example. If *X* permits *A* to return merchandise that he cannot sell at his normal 25 per cent markup and withholds this privilege from *B, B* may well feel that *X* is discriminating against him. *B* may, for example, hold that he is, in effect, paying a higher price than *A* for the units he does sell, since in figuring his profit on merchandise he buys from *X,* he must add the cost of unsold items to the cost of items actually sold.

What about special discounts for large orders? Quantity discounts for large purchases are not directly prohibited or permitted.

Such discounts are legal if they do not injure competition, or if they are based on specific cost, market, or competitive conditions. Quantity discounts are permissible if a seller's costs actually do vary with the size of the order the customer places.

Difficulties, may, however, be encountered if a seller's exaggerated discounts for large orders bear no reasonable relationship to discounts on his smaller orders.

What about credit terms? In a period of rising prices your dealers may find that an increasingly large proportion of their capital is tied up in inventory. They may, therefore, request easier payment terms than before. If you revise your cash discounts or other credit arrangements that affect price, you should make new terms available to all customers without discrimination.

What about special delivery services? You may wish to rush merchandise to buyers in your own trucks or by fast delivery service. If you do, you should make a charge for the additional service or else make "special deliveries" available to all customers on proportionally equal terms.

Check list for effective packaging of your product

What do you consider in studying your package design and construction?

1. Is there *adequate protection* against rough handling in transit and delivery to user? That includes checking for strength under both load and impact and for resistance to exposure and dampness. It also covers—

   Ability to withstand climate and temperature changes
   Sealing against tampering
   Prevention of rattling
   Interior reinforcement and cushioning
   Minimum weight for proper protection
2. Do you think of getting the *greatest possible shipping economy?* Occasional breakage and replacement may be more economical than penalizing *every* shipment by the cost and weight of damageproof con-

tainers. The natural tendency of shipping departments, in their own protection, is to overdo protection with—

Too many crates
Too many nails
Too much padding
Too much wrapping
Too much gummed tape or twine
Too much bulk
Too much weight

You may need to establish standard practices which eliminate extravagances. At the same time, relieve the shipping department of criticism.

3. Is the container *suitable for the final purchaser's needs* and preferences? Has it value to the recipient (*a*) as a permanent container; (*b*) because of salvage possibilities; (*c*) for utility in some other type of service; (*d*) to go into the production line as its own tote box; (*e*) for display? If so, use prominent space on the exterior of the package to explain it, so that its value will not be destroyed by careless opening.

When designing for retail display, make sure the package has distinction and visibility on shelf, counter, and show window. It must compete for attention not only with competitive articles but with all other merchandise near it.

It should "look its price"—that is, give the impression of being worth what is asked for it. If one item in a line, it should probably bear a "family resemblance" to the other packages. If the appearance of the contents is a sales asset, consider transparent wrappings, "windows," and glass, or a bulk display of packages with one sample exposed to view. Other important points are—

Avoid frills and elaboration suggesting that the purchaser is paying too big a part of the price for the package
Avoid bulk
If the merchandise is meant for feminine customers, avoid a package that is hard to open, requires tools, or calls for an expenditure of manual strength
Give the package good labeling. Include all the information required by law
Make it helpful to salespeople by providing easy identification and furnishing selling data
Give the complete information for the buyer, to minimize returns and complaints. Use accurate, easily legible statements of contents, condensed "how-to-use" instructions
Tie it up with product's advertising through trade-mark, brand name, company name, color scheme, and slogan
Consider additional use of bulk container for delivering store display material, selling instructions, and consumer leaflets

Consider whether the package delivered to the ultimate user should contain "how-to-use" instruction sheet, folder or slip featuring other articles in line, guarantee certificate, return card for registering buyer's name at home office

Find out whether a single "standard package" will fit buying habits of all types of outlets or whether, with different sizes, more markets can be cultivated

Find out whether the consumer market can be enlarged by offering your product in wider range of quantities

Avoid needless weight in your package design. Remember, too, that materials or colors can easily become shopworn. Do not use three- or four-color labels if, by better designing, two colors can produce an equally effective display

Avoid "overpackaging." It definitely antagonizes intelligent, thoughtful customers. Keep informed as to the many new money-saving ideas being developed. Be watchful for methods to conserve shipping space and to use easily obtainable materials, less material, or lighter material. Study recent developments, such as—

Transparent packages. (Can the amount of cellophane or other transparent material be reduced by substitution of a small "window" for a larger area of the transparent wrapping?)

Shipping packages which start their service as assembly trays on the production line

Nonadhesive films for protection of metal goods in transit and storage

More efficient and economical use of freight-car space

Envelope type "two-dimensional" packages

"Bag-in-box" containers, avoiding use of metal or glass

Fiber cans, produced on same machine used to manufacture metal cans

Waterproof glues and other new cements

Plastic-lined, spirally wound paper cans for liquids formerly shipped in tin

Climate- and temperature-resistant interlinings which permit less expensive outer containers

Cotton bags for mail and express shipments and for inclusion of small parts in larger shipments, to replace heavier and bulkier containers

Better use of packages returned to you

Use proved methods of advertising to the trade

Don't generalize in your advertising; get down to cases. Tell all to a reader. Do this:

Be specific. Advertise product by product. Readers don't buy your "line"

If you want inquiries, offer something that's really useful to the reader and tell him why it's useful

- Don't be afraid of long copy—but make it informative
- If you want direct action, suggest it in your copy, and tell the reader why he'll get something out of acting quickly
- Don't get "fed up" with your own sales story. Change the pace, use new approaches, produce fresh evidence that your story is true, but never stop telling it

Trade and business papers are an essential medium for reaching other business or dealers. The Haire Publications list the advantages this way:

Trade advertising delivers solid help to your sales force by—
- Doing a missionary job
- Selling the standing of your house
- Introducing men in their territories
- Creating leads
- Selling above heads without offense
- Making the calls between personal calls
- Calling on more prospects
- Getting a special message over to all buyers
- Covering all buying powers regularly
- Building morale of your salesmen
- Paving the way for successful interviews
- Selling with "reason-why" appeal
- Keeping dealers sold
- Reaching the new man on the job
- Reaching buyers who are hard to contact
- Ensuring business momentum
- Consolidating all sales gains
- Maintaining contact between peak business seasons

Trade advertising plays a vital role in marketing operations by—
- Selling the primary channel of distribution—the dealer
- Winning and holding dealer loyalty
- Speaking the dealers' language
- Introducing new products, new styles
- Giving the dealers down-to-earth, nonglamour information they need and want
- Announcing prices
- Talking profits and turnover
- Discussing new developments
- Developing distributors
- Moving goods that have been sold to distributors
- Promoting dealer aids and their use
- Training dealers how to display products
- Inducing them to tie in with national drives
- Aiding in sales training
- Getting cooperation of dealer sales staffs
- Tying in with trade shows
- Merchandising consumer advertising campaigns
- Developing repeat business

Trade advertising ensures the stability, development, and good public relations of business by—
- Maintaining momentum of business with dealers
- Protecting against price competition of nonadvertised brands
- Offsetting ill will of neglected customers

Discouraging substitution
Forestalling competition of new companies
Keeping the trade-mark in the forefront
Reselling lost customers
Explaining delays in deliveries or service
Preventing industry from thinking that business is slipping
Building confidence in the company's financial structure
Testing salability of new items
Building up additional items in the line
Opening new markets
Cultivating future buyers
Publicizing additional services
Interpreting the policies of the house
Counteracting illegitimate practices in the industry
Doing a good public-relations job with all outlets

Planning an efficient sales organization

First, do a good job in selecting and training your sales force. Make the selection by a plan seeking to avoid misfits. Part of that is your method for a thorough checking of applicants' aptitudes, courage, and honesty. Be on watch against—

Applicants with poor credit reports against them
"Floaters" who have had too many jobs
Men too thoroughly imbued with competitors' products and methods (it may be hard to teach them new ways)
Men with "trouble" at home
Men whose attitude suggests that the job is only a "stopgap"
Men whose references prove noncommittal

Carefully design your sales training program. Even the "born salesman" is up against the stiff competition of carefully trained and coached men, stimulated by constant inspirational means. Your training procedure should be planned to—

Convince your representatives completely of the value of what they are selling and what it will do for their customers
Inspire them with respect for the company which they will represent
Imbue them with its basic philosophy and aims
Give them as detailed an understanding of the manufacturing process as will be useful to them in the field and guard them against misstatements
Give them a thorough grasp of all factors which differentiate your type of product and the markets you cultivate from what they have known in other sales work
Sell them on the importance of all reports you expect of them; the soundness of any unusual sales policies; the value to them of the close supervision you will give them

Provide a method by which they can check up on their own performance in order to take maximum advantage of their opportunities
Show them how you will keep them informed as to trends and developments in salesmanship
Give a clear picture of the means you will employ to increase the effectiveness of their personal effort and furnish additional opportunities for income

Keep in mind that any ably handled training course is one of the quickest means of "selling" a company to its new representatives and sending them out into the field under full steam. Lay them out in group sales meetings in complete detail and stick to the schedule. Don't handle them informally and thus belittle their importance. Don't cover too much territory in any one session. Use these techniques—

Employ showmanship in emphasizing and dramatizing main points (set them an effective example of how to do this)
Encourage questions and general discussion, but watch out lest the sessions drag and grow tiresome
Make a clean-cut statement before each session on what will be covered, and summarize the day's topics at the close
Omit any topics of interest to only a part of the group; cover these in separate talks with the individuals interested

Show salesmen how to meet customers' complaints effectively. Make certain that your salesmen know exactly how to explain shortages, delayed deliveries, changes in packaging, discontinued items, etc., so that they can effectively handle criticisms and complaints.

Use the meetings to educate new salespeople on detailed "how-to-use," "how-to-sell," and "how-to-display" bulletins which your salesmen can give out freely to make sure that new customers, novice factory labor and foremen, and inexperienced clerks will quickly learn to do justice to your products and their reputation.

Helping your salespeople get more sales

That needs study of the way you handle your men.

For one thing, conserve sales time. The job of a salesman is to sell. Don't load him with duties which will cut into his selling time. Don't require him to make out lengthy, detailed call reports, unless the home office puts the information to real use. Other points to be studied include—

Consider whether your compensation plan needs overhauling to meet changed conditions
Be sure your contact with salesmen is sufficiently frequent to keep them in good spirits and give them a sympathetic understanding of your company policies

Put additional emphasis on placing all pertinent information in their hands in definite, easily understood form
See that you are giving them the best possible support in the form of letters and mailings to prospects before and after their calls
See that their complaints or questions are answered promptly and understandingly
Don't let the stress of office activities get you out of touch with the men in the field
Keep them interested in the future by telling them of your research activities
Coach them carefully on how to present these activities to jobbers and dealers and how to make use of them in talking to users
Take the steps necessary to replace salesmen, and have them ready to carry on efficiently

Make full use of *work stimulators.* Here are a few standard procedures, some of which should be applicable to your operations:

Weekly bulletins showing comparative standings, commending notable accomplishments, giving case studies of successful sales stratagems
Prize contests—with merchandise, cash, or savings bonds offered to successful salesmen (or their wives)
"Topnotchers'" clubs of the year's leading producers, with membership pins or buttons
Special drives: new accounts; getting back old customers; pushing a selected item; best window trim or store display; "president's month"
Special rewards for making quota, reducing ratio of expenses to volume, submitting worthy ideas, interviewing many new prospects, maintaining good call reports
Calls at organized intervals from home-office executives
Personal letters to acknowledge notable sales, winning over rough prospects, improvement in volume, economical operation, etc.

Get full use of salesmen's capabilities. *Salesmen can help by educating customers* in the operation of your business and theirs. And they can help in—

Keeping customers informed on how others are meeting the new competitive status
Interpreting current difficulties, delays in shipments, errors, and cancellations to keep them from being dissatisfied
Going over their problems with them to give them the benefit of other people's experience
Telling you how to bring your own selling and promotion in line with what they find to be current conditions in the field
Bringing back to you all the data they can secure on the difficulties cus-

tomers are encountering to help make your own production and marketing effort more profitable

Be ready to make territorial realignments. Place your men where they and you can best take advantage of changes required by these principles:

Keeping travel costs at a minimum
Letting salesmen concentrate their time in the most productive markets
Taking into account the mass shifts in population; also the increased buying power of industrial labor
In areas where telephone facilities are not overloaded, substituting telephone calls at a prearranged time each day to take routine, everyday orders from regular customers

Change the tune of your sales meetings. Be prepared with authoritative staging, equipment, and showmanship. Give them proper chairmanship and adequate timing. Also follow these pointers:

Keep the discussions relevant to subjects that make for easier selling today
Hold down the topics; give an intensive educational or inspirational handling of all subjects discussed
Don't run overlong sessions; have adequate ventilation, good seating and writing accommodations, good acoustics
Make sure of sufficient audience participation on a systematic basis

How your salesman can use his time most productively

Recognize that time spent in contact with prospects is the productive part of a salesman's day. Do all that you can to build up the ratio between productive and nonproductive time. Here are some aids:

Show salesmen the value of keeping a personal "score card," giving a day-by-day record of—
- Productive hours in contact with customers and prospects
- Hours in travel
- Hours spent on routine records and correspondence
- Number of calls made and number of interviews
- Expenses
- Number of orders and total dollar volume

Teach them how to study it to discover—
- Ways and means of increasing the ratio of contact time to total time
- Accounts (or prospects) using up more time than their business justified
- Evidence of poorly planned routing (too much mileage or travel cost per interview)
- How their sales effort is divided between *A, B,* and *C* prospects

Study and discuss with salesmen: the high cost of hours diverted to personal affairs during the working day; the waste involved in asking for and interviewing the wrong man; the rewards for getting started promptly in the morning and staying on the job as long as possible; the lost effort in calls made without proper preparation and material. Here are real aids in your planning:

- Give clear instructions as to which prospects should get the bulk of their attention, and which can be neglected or used only as "fillers" in otherwise wasted time
- Plan routing carefully
- Plan just how often you want them to call back on each customer or prospect
- Warn them to avoid the salesman's easy error of dropping in too often where they are sure of a friendly welcome and staying away from those places where the ice still needs to be broken
- Use a system which discloses when a salesman is spending too much time on an unprofitable account or an unpromising prospect
- Assign them territories which can be efficiently and economically covered
- Encourage the flow of daily reports from men. They will give you an opportunity to review their production and permit your criticism and encouragement

Keep your sales record adequate. It should permit you to move quickly. Have salesmen give you enough information to—

- Check their call reports against your prospect files to control their movements
- Check their expense reports to prove their coordination with call reports
- Check the quality of their calls
- Check the results from each type of promotion
- Find the actual production of each man
- Get the actual cost of each man

Make sure salesmen have records of customers' activities to keep them abreast of what is occurring with their own people. Possibly send customers' complaint reports to men to keep them advised in their own efforts to save customers.

Study call reports to be sure that worth-while prospects are not being consistently neglected through no fault of the salesman. That may mean a reduction in territory, assignment of a junior salesman to cover "B" prospects, or finding out whether a salesman thinks, or knows, that he is "in wrong" with the prospects he neglects. And do this:

- Make sure that the sales kit and the verbal presentation of their commodity are both planned to save salesmen's and prospects' time by getting straight to the point and sticking to it

Check up frequently to make sure that they haven't forgotten what they were told

Make sure that your training program is kept alive by personal example or stimulating bulletins

Point out to salesmen the waste caused by common mistakes and bad habits, such as—

Using working-day time for planning trips, writing reports, etc.

Attempting to handle too big a territory for best results

Assuming that successful interviews can't be made the first thing in the morning, late afternoon, or on Saturday morning

Trying to win or hold the prospect's attention by spreading gossip and rumors

Putting in too much time on "long shot" and "fringe" business

How to control your salesmen's expenses

You need to set up a fixed policy on your expense arrangements. Make it a completely detailed, mutually understood statement about allowable expenses which will be paid by the company. Set a definite rule stating exactly how they must be reported and substantiated by the salesman in a permanent reference form.

Before establishing the system, consider providing for these expenses in the salary or commission paid each salesman. That frees you from further responsibility. Or you might set a per diem or other flat-rate system.

The expense manual or instruction sheet should cover your policy concerning all expenses incurred away from home on the company's business, including—

Hotel rooms in cities of various sizes (consider the use of due bills)

Meals, also according to size of cities

Extra-charge accommodations on trains

Use of airplanes

Tips

Taxis

Valet, laundry, and shoeshines

Telephone and telegraph

Sunday expenses when away from home

Entertainment

Expenses when in a home town (lunch, etc.)

Completely detailed understanding as to automobile costs—mileage rate, insurance, depreciation or upkeep, tires, daytime parking, overnight storage, home-town use, distance limitations (no long trips), allowance when used in place of cheaper transportation, etc. Look into the advantages and disadvantages of per diem rate

Provision for combination business and vacation trips

How and when expenses shall be reported and when they shall be payable
What receipted bills or other supporting evidence shall accompany expense reports
Association and club initiation fees and dues
Any matters peculiar to your line of business that might occasion misunderstanding and disputes

Now set up your reporting and auditing system by giving the salesman a simple and convenient report form. Provide for inspection before approval by the salesman's direct superior and an accounting-department official. Be sure, too, your system does this:

Provides a means by which costs can be checked against railroad and pullman rates, bus fares, and other provable items
Furnishes a quick comparison with salesman's previous costs and those of fellow salesmen operating in similar territories
Shows ratio of expenses to sales volume
Discloses information permitting economical salesmen to be commended or rewarded for their thrift
Provides for prompt payment to salesmen

This is the beginning of the check to avoid salesmen frauds. This scrutiny of expense accounts should spot items out of line. But your check should also include—

Actual check of salesmen's reports with receipted bills or your definite knowledge of costs for various traveling and expense activities
Insistence, wherever practical, on receipts for all items in expense accounts
Check to rate books for railroad, pullman, bus, and any other charges that can be proved
Curtailment of excess costs by effective bulletins to traveling people on—
- Failure to take advantage of round-trip rates
- Unnecessary pullman accommodations
- Excessive charges for meals
- Unreasonable entertainment expenses
- Unnecessary telephone and telegraph costs
- Unreasonable use of taxicabs

Audit of all traveling expense accounts is essential if experience means anything. Too often excess mileage between various points is found in them. In a great many cases they are incorrectly added or extended.

Often the salesman's call reports and traveling expenses will vary, suggesting that one is in error. Too often, sleeping accommodations for both pullman and a hotel are found on expense accounts for same period.

Similarly there are repeated items for taxis or bus fares when automobile expense is already charged for. Expenses for porters or tips are often charged when the quantity of luggage may be very small.

How best to sell by direct mail

Letters can be long except when addressed to business executives. You must always make specific appeal for definite action. Use some offer or inducement whenever possible. Make "you" the central figure in your letter, rather than "I" or "we." Be newsy; be personal; localize appeal where possible; tell your *whole* story. Other techniques recommended by experts are these:

Employ "subheads" in the body of the letter to give your message quickly and to stimulate a desire for ownership
Make use of margins for sideheadings
Arrange the sequence of your letter to give main points quickly. Restate them at least once more (except in letters to business houses) before signing off
Use postscripts for emphasizing a special appeal or summing up an offer
Two-fifths down the page is the "visual center"—place an important part of the letter at that spot
Get attention with illustrations, cartoons, display boxes, display circulars, underlining in black crayon or colored pencil. Key paragraphs in color also help

Format suggestions by experts urge that elaborate or expensive setup is not essential for the great bulk of commodities and service advertised by direct mail. A two-color letterhead usually proves a better investment than a one-color one for form letters. Other comments urge—

A printed letter with an arresting headline is cheaper than one personally filled in and is equally productive for some lines
Hand-addressed, type-addressed, and stencil-addressed envelopes show almost similar results for most uses
In a series of mailings, variety should be employed to avoid recognition before opening; color, size, and style of envelopes and letterheads may be varied
A letter-size sheet without company heading, but with a striking headline or illustration, is effective
If letter extends beyond one page, it is better to use two sheets rather than reverse side of first
The color of your envelope has little or no effect on returns

The most widely employed types of mailing are the letter without enclosure; the letter with enclosure, which may be a circular, reply card, or order blank; a circular alone enclosed in an envelope; sometimes a circular or broadside is self-mailing without an envelope.

For most commodities and services the letter is the most nearly indispensable element. Experts suggest that the attachments be handled this way:

On a single-page letter mailing, the order form may be put at bottom of letter
If letter and circular are used, the order form may be put on separate card or may be a part of the enclosed circular (back cover)
The cost of a two-color reply card is not usually justified
A blank reply card will ordinarily produce as well as one which has been filled in
It is well to be wary of using reply card inviting or suggesting that a salesman will call
Air-mail reply cards are not justified, but the "No stamp required—we'll pay return postage" type of card should be tested

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How to cut costs in direct-mail sales

Notice these results of tests:

The common use of metered mail on business correspondence has made it equally or more productive than stamped mail in direct-mail work
The expense of first-class mail is not warranted until, by test, you have proved that it pays out; third-class mail usually pulls as well
Avoid mailing for Monday delivery

The development of a mailing program of maximum productiveness is a matter of constant testing. The extra expense of using split lists, or other testing devices, is rarely a waste *if* you study the comparative results and apply your findings to future mailings.

Once you have established some standard of results by which to measure all mailings, you will be in a position to take the additional precaution of testing out a proposed letter on a small sample of your list. That avoids undertaking the whole investment without any gauge of the returns you can expect.

Experts urge you to keep testing the individual details of mailings by using different materials on alternate names on lists; for example—

Letter *A* vs. letter *B*
First-class vs. third-class postage
Circular or no circular
Order blank on letter or separate order blank
Blank vs. filled-in reply card
Return postage paid by prospect vs. return postage paid by you
Filled-in heading vs. generalized heading
Style of addressing
Offer of premium vs. no premium
Mailing dates
Cheap stationery vs. more expensive
Letter processes
Self-mailing pieces vs. pieces enclosed in envelopes
Blind envelopes vs. envelopes showing source

And experts also urge you to keep a record of your tests of direct mail this way:

Keep a detailed cost sheet for each mailing, covering all items of expense, number mailed and identification of list used

When returns are in, tabulate the number of replies, volume of orders received, cost per reply, and cost per dollar of sales

Use these as the basis of all test comparisons: pulling power of copy appeals; style and contents of mailings; productiveness of lists

How to build productive direct-mail lists

The first step in organizing for direct-mail selling is the building of a mailing list through card files maintained in the home office, or through the service of a mailing house.

What are the best sources, or best combination of sources, of names for your list? They probably are—

- Your customer ledgers, current and past
- Your salesmen's call reports
- Trade directories
- Lists purchased from mailing-list houses
- Names or lists furnished by sales outlets
- Telephone books and classified directories
- Club and association membership lists
- Names in competitor's lists of users
- Names secured from news columns of publications
- Names furnished by clipping services
- Prospects suggested by satisfied customers—
  - Offered voluntarily
  - Brought in by letter requesting suggestions
  - Brought in by offer of a gift
  - Brought in by offer of financial or other reward if sale results within specified time

You ought to use a prospect card file to assemble your list if it is possible. If you do, it should cover the name and address in complete form, plus this sort of data:

- Source of name (to help in evaluating sources)
- Date when put on list (as a check on unproductiveness)
- In case of a business concern name and title of individual, if known
- In a large organization additional cards for all individuals influencing purchases

How do you check the accuracy of your list? Many methods are available:

- By return card asking whether mailings should be continued
- By local postmasters, for a fee
- By your own salesmen, for their territories

By key distributors, for their areas
By submitting to mailing-list houses
By your own executives

Guaranteeing return postage on mailings will help maintain quality of your lists. So will these steps:

Comparison with salesmen's call reports
Insisting that salesmen promptly report all changes
Withdrawal of unproductive cards after a fixed interval
Constant check of the names against established list sources

Your wholesalers may be able to help you operate efficiently

One aid is in providing storage space for the manufacturer. Wholesalers can buy and store goods at the time they are produced and hold them until they are needed by local retailers or industrial consumers. This greatly reduces the amount of warehouse space needed by large manufacturers. It eliminates the need for storage space by many small producers.

The wholesaler can often make better use of storage space than can most manufacturers. The production of many processors is seasonal. Were it not for the wholesaler, they would have to provide storage space for their maximum seasonal output. Therefore, as the goods were moved out, space would be vacated which would remain idle until the opening of the next season. The wholesaler, on the other hand, carries goods for every season. As goods for one season are moved out, those for the next season are moved in. Consequently, space is more fully utilized. Other aids can be—

The wholesaler *lessens substantially the amount of capital needed* by the manufacturer by buying goods as they are produced and paying promptly for them. Capital requirements are less than if the manufacturer had to hold the goods until they were needed and paid for by retailers

By distributing through wholesalers, *some manufacturers are able to ship their products, at good prices and for cash, as fast as the goods are ready.* This gives them money with which to continue operations until the season is ended. It also eliminates the necessity to have a storage warehouse, to maintain a year-round staff for shipping small orders as they come in from the various retailers, and to keep a selling staff of sufficient size to cover a large enough portion of the market to dispose of the entire stock

Manufacturers can sometimes arrange *sale of their entire output to* a limited number of large direct buyers whose offering price might normally approach the break-even point

A manufacturer can get *national distribution more quickly* and more thoroughly through wholesalers than by any other means. If he attempts to sell direct to retailers he has to train and send into the field a

large staff of salesmen, who commonly enter upon their duties as strangers to their prospective retail customers. On the other hand, the wholesaler's salesmen usually are old friends of the retailers on whom they call

Wholesalers speed sales of new lines of merchandise. Retailers buy more readily from the wholesaler because, through past dealings, they know he is reliable and would not burden them with goods that he knows are not suited to their trade. They also realize that he is nearer at hand than the manufacturer and that adjustments on unsalable merchandise can be had from him without a great deal of correspondence and bother

Wholesalers can give protection of market. If there were no wholesalers, small and medium-sized independent retailers would be only a minor factor in our marketing scheme. No manufacturer would enjoy sufficient coverage without selling through chains. They furnish many other aids:

The wholesaler can *keep the manufacturer advised on market conditions,* the nature of the goods which can most readily be sold in the market, the type of package which consumers seem to prefer, and the size of unit which makes the greatest appeal. Thus, where the manufacturer employs wholesalers in many areas, he receives a constant flow of marketing information which guides him in making decisions

They give a selection of retail agencies. The wholesalers and their salesmen, through long business association, know intimately the operations and character of the individual retailers. Therefore, the processor who uses wholesalers and who desires to establish retail agencies for a line need only inform his wholesalers of his intentions and give them detailed instructions

The wholesaler cuts advertising expense. He is the agency through which manufacturers may distribute their advertising to retailers. The material is sent to the wholesaler. He makes it up into kits, which are given to his salesmen to deliver to each of their retail customers. The only cost to the manufacturer is shipping the bulk material to the wholesaler. The cost of this procedure contrasts with the cost which would be entailed if the manufacturer had to make up the kits and mail them to thousands of individual retailers

The wholesaler lowers substantially the handling cost of the processor. When distributing through the wholesaler, the manufacturer often merely has to load full cars and ship them on. If he sold to retailers direct, it would be necessary for him to employ a much larger warehouse force to fill the small orders which would come in from retailers. Many would be shipped by express or parcel post rather than in carlots by freight. This would necessitate special packing and weighing of many orders, with a consequent increase in expenses

By ordering goods in carlots *the wholesaler not only lowers the distribution costs of the manufacturer, he contributes to lower costs to retailers*

The wholesaler greatly simplifies the credit problem. If the manufacturer were selling direct to retailers, he would have to keep a check on thousands of accounts in widely scattered localities. When the wholesaler checks the credit of a retailer he does so for all lines he carries

How you can promote sales through retail outlets

Retail stores often like sales instruction and cooperation. That might be a regular mailing program to keep information up to date. Or it might be by bulletins or a dealer magazine; supplying educational material (sales manuals) to all salespeople handling your line.

Your job is to give them all possible selling helps. The needs of retail outlets vary according to type of outlet and size of organization. The following is a list of the major helps offered by manufacturers:

Product exhibits
Store demonstrations with factory representatives on the job
Group meetings of salespeople to hear announcements of new items, new advertising campaigns, etc.
Dealer contests for window display, store display, newspaper advertising
Prize contests for clerks, or premiums for sales made
Window displays and trims
Counter cards and wall hangers
Display racks
Ready-to-use advertising electros and mats
Advertising suggestions in proof form
Portfolios showing available advertising material, with order blanks provided
Outdoor signs, metal, cloth, waterproof paper, etc.
Store signs (exterior use) in wide variety
Decalcomania door and window signs
Sales literature for store distribution
Envelope enclosures
Letter campaigns or suggestions for letters on retailers' stationery
Special window displays and exhibits remaining the manufacturer's property and routed from store to store
Advertising allowances
Cooperative advertising, shared by store and factory
Cooperative advertising by groups of outlets
Personal activity by salesmen in setting up window and store floor displays
Payments for use of show windows
Help in preparing mailing lists and the material to be sent out
Salesmen or special experts who offer sound advice on management problems, suggesting new sources of income, or show how to handle criticisms occasioned by changes in product, packaging, and policies

How you can promote sales through jobber outlets

Jobbers like a market analysis. It should furnish a list of prospects in the area each one covers for each item you manufacture. Start it by checking the jobbers' mailing lists for inclusion of all desirable names. Furnish, too, specific instructions about the use of your product in all out-of-the-ordinary markets.

What ammunition can jobbers' salesmen use effectively? That varies widely. All the following demand consideration:

- Catalogue pages and inserts
- Full-line catalogues of your line
- Product bulletins
- Sales manuals
- Portfolios of advertising material
- Visual presentations
- Sample kits
- Direct-mail literature for own use, especially envelope enclosures
- Store and window signs: "Selling Agents for . . .," "Exclusive Representatives for . . .," etc.
- Sales literature to be furnished dealers
- Window displays; wall hangers
- Showroom displays and demonstration material
- Displays for exhibit booths
- Materials suitable for their house organs and other mailings
- Help in planning the above promotions
- Order blanks for their use in arranging shipments of advertising to retailers

Jobbers often will permit you to show their sales forces, by groups or individuals, how to present each item in personal sales work—or to make actual calls in company with jobbers' representatives. You may be able to help them with the following other cooperation:

- Arranging to give expert demonstrations to selected prospects
- Presenting new items, new advertising campaigns, new sales portfolios to group meetings of sales forces
- Maintaining a list of jobbers' salesmen and addressing to them personally all bulletins, pep letters, etc.
- Suggesting prize contests for salesmen
- Organizing special sales drives on an item or full line
- Assisting at conventions and exhibits—
  - Through help in planning display
  - Through personal attendance of factory representative
  - Through demonstration equipment
- Being on call for "trouble shooting" in case of difficulties with their outlets
- Checking up on stock on hand and seeing to it that a properly balanced inventory is maintained
- Attending, when invited, jobbers' house picnics, dinners, etc.

Be sure you know the cost of plant selling

This will permit you to select commodities, methods of distribution, and quantities in which sales or delivery can be made so as to secure the largest possible profit.

Cost studies permit you to formulate intelligent plans for the future. They guide you in checking your present operations against the standards and budgets you have created.

Federal and state legislation prohibit discriminations in price. They make it essential that you be aware of the possible dangers in selling commodities to various classes of purchasers at different prices. The various antidiscrimination acts generally permit actions against you if your prices might be charged to be unlawfully discriminatory. *But different prices can be justified by proving cost differentials.*

Be sure you know how to find the cost of plant selling. As in production, there are opportunities for reducing costs in marketing through the improvement of efficiency.

Progress lies in this direction. An improvement in efficiency and a reduction of marketing costs offers opportunity for lowering prices, increasing net profits, and improving a competitive position.

No company makes all its sales at equal profit. In every business there are sales which are much more profitable than the company average and a sizable proportion of other sales which are much less profitable.

These are basic facts of business life which marketing executives encounter every day. Yet these commonplace truths hold "secrets" which so far have been acted upon by only a few companies.

In most businesses, a large proportion of the number of customers, orders, and commodities, bring in only a minor proportion of the sales. Such a distribution of sales would not necessarily result in unprofitable business, except that marketing efforts are costly. Hence, marketing costs all too frequently follow the number of customers, orders, commodities, and so forth, rather than the actual or potential dollar sales. In other words, a large part of the marketing expenditures are "responsible" for securing only a very small part of the total sales and gross profit results.

Intelligent small businessmen are thus faced with a need for marketing cost policies, such as—

How many and what kinds of customers to sell
Which channels of distribution to use
Which territories to cover
Which products to sell and at what price
Where and how to apportion their marketing efforts in closest relation to

potential sales results (estimates of market potentials by territories, products, and customer classes)
Where the relatively unprofitable sales are, and the reasons for the sources of loss; ways and means to make these sales profitable

The whole cost of distribution should be included in your studies. That includes—

Promotion, advertising and anything else that serves to create the demand for sales
Selling facilities of all kinds
The entire delivery process, together with any storage, warehousing or handling costs incident to the sale
The functions of credit approval and collection

You need to analyze all costs in terms of the type of selling you do. You should seek at least the costs and profit incident to each type of sales. And seek these other facts:

The pricing policy that will come from such analysis (possibly different territories require different scales; various classes of consumers need different prices)
Cost of sales by territorial divisions, branches, or field locations; type of customer served; method of selling employed, dealers or jobbers vs. direct sales to consumers
Costs of sales for specific products
Unprofitable customers (seek a better price for such distribution, or make continuance of such sales a house policy comparable to advertising or goodwill promotion)

The assembly of costs by type of selling should be fair to all classes. That is simple if distribution costs can be directly charged to individual sales classifications. But where that is not readily possible, a fair system of apportionment must be found. That can be based upon detailed analysis of all costs in behalf of all services or functions.

A great many studies have been made of methods of allocating costs for all types of distribution costs. If you want details on the subject, get particularly, from the Federal Trade Commission at Washington, "Case Studies in Distribution Cost Accounting for Manufacturing and Wholesaling." Study with your CPA its detailed experiences in the allocation of—

Sales supervision and sales office expenses
Compensation of sales representatives
Advertising costs
Warehousing costs
Stock handling costs
Local delivery expenses

Use of costs in handling ordinary—
  Credit and collections expenses
  General and administrative expenses

Be sure you seek full analysis of salesmen's costs. They should be recorded in detail so as to determine justification of the expense through—

Elimination of backtracking and useless traveling
Comparison with calls budgeted
Relation of sales to calls
Careful scrutiny of the reasonableness of the expense item
Comparison with budget
Comparison of cost to income produced

What to look for in your cost studies

Elimination of unprofitable sales is not the only method—or the most desirable method—for dealing with unprofitable business. Here are some of the policies (all available by good distribution cost analysis, readily installed for you by your CPA) for converting relatively unprofitable commodities into sources of profit:

Simplify the line. Reduce the number of sizes, styles, qualities, and price lines. Simplification may result not only in reducing distribution costs, but also in increasing sales, by permitting concentration of advertising, selling, styling, and design on a smaller number of items. One knitting mill, for example, sharply reduced its storage costs and inventory losses by restricting the variety of articles offered for sale and attributed a rapid increase in sales to that policy.

Repackage the product. A change in the package may reduce the direct costs of packing, and the new container may make possible reductions in transportation, storage, and handling costs. A new package may also influence the volume of sales.

Increase—or decrease—the amount of advertising and promotion work. Whether it would be profitable to increase or decrease advertising depends on such factors as the effect of advertising on volume of sales and the effect of the volume of sales on unit production and distribution costs.

Decrease the price. Sometimes, it may actually pay to reduce the price of unprofitable commodities. When consumer demand is so elastic that a small reduction in price leads to a substantial increase in sales, the result may be a greater excess of dollar gross margin over distribution costs than the net contribution of the commodity at the old price. This may come about as the result of both an increase in the unit of order with a reduction in costs and an increase in total sales sufficient to at least counterbalance the loss of gross margin per unit of sale that follows the price reduction.

Increase the price. Where an increase in price may lead to only a small reduction in sales, it may be possible to raise the price in order to recover the loss

on unprofitable products. This would be true if the increase in dollar gross margin would exceed the increase in per unit cost of production and distribution that might result from the lower volume or the smaller unit orders.

Many possibilities also exist for minimizing the losses resulting from orders that are relatively unprofitable because of their small size. Some of these are—

Devise special routine for handling small orders. One electrical manufacturer, for example, uses only about 25 per cent of the usual clerical routine in handling small orders
Reduce services offered on small orders, such as special storage, free acceptance of returns, and repair services
Minimize broken-package sales by reducing the original package unit, by employing package units of several different sizes, or by developing special-assortment packages for filling small orders
Make a special handling charge for all orders below a minimum size
Employ quantity discounts or increase present quantity discounts with the size of the order. Quantity discounts must, of course, be in line with cost differentials
Establish a minimum size order that will be handled
Offer bonus to salesmen for orders above a certain size, or penalize salesment for orders below a certain size
Turn small orders over to jobbers, brokers, or agents
Turn unprofitable customers into profitable ones by directing salesmen to call on them less frequently, or to solicit by telephone
Substitute mail-order solicitation for personal calls on a number of customers of certain classes
Minimize the losses resulting from small orders, such as the development of special-assortment packages, which do away with broken-package sales

How you can exploit undeveloped profit possibilities

Salesmen usually send in a continuous flow of criticisms of present products, suggestions or demands for improvements, and requests for new products. Maintain two files of all such material—one labeled "Improvements," the other "New Products." Then consult both at regular intervals—particularly when considering changes in your product.

Encourage your foremen and factory workers to submit ideas and suggestions for new products and production economies. Reward those who make suggestions that are adopted.

Give someone in your organization specific responsibility for keeping watch for suitable additions to your line and reporting his findings or suggestions at regular intervals.

Study a mailing list catalogue for classifications to which you should be

able to sell your product but have not been cultivating. Buy or prepare lists of such customers for each of your salesmen. Furnish special sales literature for each market if your standard catalogues or bulletins do not meet the needs of the new markets.

When an order is received from an unusual source, find out why your product was purchased. The information may disclose a market for your product or an application of it that had not occurred to you.

If your competitors publish lists of users of their products, study them closely for suggestions of classes of prospects or uses for your product which you have been overlooking in your sales work.

Someone in your organization should carefully read the publications of your trade or industry for news items concerning—

New businesses in any of your markets to add to your prospect list
Personnel changes in firms already on your prospect list
News concerning competitors—product announcements, advertising plans, merchandising plans, new salesmen, distributor appointments, organization changes, new facilities

Keep up an analysis of the parts or processes connected with your product to disclose any which, though needlessly expensive, you are using because "that's the way we have always done it." Be sure you are always investigating money-saving possibilities of "substitute" materials which recent research has developed. Effective developments include such economies as—

"Metalizing" to salvage metal parts damaged in production or handling
Use of substitute materials, plastics, moldable plywoods, vitreous enameled plywoods, Fiberglas, silver, low-tin babbitt metals, hard-coated softer steels
Simplified, "streamlined" packaging, minimizing the use of metal and making use of the new climate-resistant wrappings, adhesives, and seals

Product study also includes checking for elimination of "gadgets" which add to the manufacturing cost of the product but contribute little to its actual value; for example—

Finish, exterior or interior, more expensive than necessary
A tendency to grow needlessly elaborate in packaging. Restudy to see if it can be simplified and made less expensive without loss of protection
"Gingerbread" that can be eliminated
"Accessories" that are of value as selling points and are actually rarely or never used by purchasers

12. HOW TO MAKE PROFITS IN WHOLESALING

How can wholesalers make money today?

What steps should they take to improve the competitive status of their retail outlets? What steps can reduce the expenses of handling a larger volume of goods?

How can they protect their gross-margin rates? A most important aid is in a Department of Commerce booklet listed in Chap. 14. Much of the material contained here is from Department studies.

One step toward profits is in the closer relation that wholesalers have established with their retail dealers. They have done this to assure themselves they can push their goods through to the ultimate consumer. To do this—

Wholesalers merchandise their controlled brands more aggressively. They have an active program of dealer aids, cooperative advertising, and competitive retail pricing policies. The progressive merchandising of controlled-label goods represents an attack on the problem of declining gross margins. It tends to improve the competitive position of the wholesaler-retailer combination.

They get better pricing policies. They help retailers to compete with the chains as regards prices. At the same time they assure themselves an adequate average gross margin. This means following the leader-merchandising principle, with greatly varying gross-margin rates in different lines, and still ensuring an adequate dollar gross margin on the entire volume of business.

Why cost control is so necessary in wholesaling

In order to operate successfully, it has been necessary for the wholesaler to introduce a highly effective system of cost control. Customer and product control ranks high.

All-important, because of narrowing gross margins, increasing expense levels, the prevalence of leader merchandising, and the increased merchandising of controlled brands, is the control over salesmen. The methods used are—

Check of sales and margin analysis. Some wholesalers check up weekly on the gross-margin rates by departments—that is, sales volume secured by each salesman in the various departments—and by classes or brands.

Some check the dollar gross margin of each salesman, minus direct expenses for which he is responsible, as a means of finding his effectiveness.

Records of the total or departmental sales to each customer. These also help in evaluating the salesmen's efforts.

Closer control over the credit-granting powers and the collection activities of salesmen. Wholesalers have sought to overcome the weaknesses of salesmen in credit and collection work. They use records which disclose current conditions in the outstanding accounts of the salesmen's customers. These policies and more stringent credit have reduced accounts receivable and bad-debt losses.

Methods of compensating salesmen. These are closely related to cost control. More and more wholesalers are finding a commission based on dollar gross margin to be more satisfactory. Even the gross-margin basis may not provide a sufficient incentive to salesmen. Adjustments have to be made, such as extra rewards for expense reductions and increased volume, or deductions for overdue accounts and price shadings.

Boldness in customer selection—not based on the matter of sales volume alone. Net profits are a function of two variables—dollar gross margins and dollar operating expenses. They may be changed by a shift in either or both of the variables. An increase in net profits can be effected by eliminating unprofitable customers, even though such a move reduces the total sales volume. Net profit position is often improved. Wholesalers can save in dollar operating expense an amount greater than the dollar gross margin they give up.

Turning unprofitable customers into profitable ones by the method and adoption of the policy of offering inducements to the retailer who increases his order size. This is important; it cuts credit delivery, and selling expenses.

Appraisal of the relative profitability of brands based on two factors—the expense of handling the given brand, and the dollar gross margin contributed by it. Wholesalers are prone to judge the profitability of brand groups on gross-margin rates. They may neglect the contribution the brand group makes to the net profits of the business. A brand may carry a high gross-margin rate. But, because of small sales volume, it contributes little to the dollar gross margin of the business. On the other hand, a brand may have a low gross-margin rate. But, because of large sales volume, it contributes a satisfactory amount of dollar gross margin. It is necessary to look beyond the dollar gross margin to determine the relative profitability of handling different brand groups.

A system of inventory control to weed out the slow-moving items, prevent "out of stocks," establish optimum purchase quantities, and achieve a high rate of turnover.

Constant analysis of sales proportions, gross-margin rates, dollar gross margins, and expenses, by departments.

Planning physical operations that reduce handling costs

Examining physical operations that reduce handling costs has growing significance. That ensures—

- Working arrangements with the retailer to increase average order size, reduce selling efforts, and establish regular schedules for sales calls and deliveries
- All necessary moves to reduce the expense of the physical handling
- Much of attention to reduce the clerical and office expense and facilitate operations throughout the business, especially in the warehouse. These are designed to ensure a smooth flow of work and an elimination of duplicated steps. They are integrated with the selling, warehousing, delivery, and other operations of the business
- Control by adoption of the "selected line" principle to the assembly of orders in the warehouse. This involves a separation of the function of order handling from that of storage and the establishment of a route which warehousemen follow in assembling the goods
- Far-reaching changes in internal physical operations, to avoid assembling goods from all over the warehouse. This allows the order-assembly, receiving, and shipping operations to proceed in a less haphazard manner. Wholesalers now try to keep separate the functions of storage and order assembly. They have systematized the operation of the assembly function by setting up an assembly line. Many wholesalers who do not have the proper facilities have been able to accomplish expense savings by setting up semiassembly lines
- Control of delivery expenses to find: what are the most suitable kinds, sizes, and types of equipment? Is contract trucking or owned trucking the more economical? Does the coordination of sales and delivery routes permit speedy deliveries to customers?
- Planning for the loading of trucks and routing the stops in a logical manner. This arranges for a regular schedule of deliveries, rolling fully loaded trucks over as much of the route as possible
- Studies to find buildings designed to meet the needs of wholesalers. They have made it possible to reduce expenses all along the line—receiving expenses, order-assembly expenses, and shipping expenses. The move to a new building may even result in the reduction of some of the occupancy expenses

Sometimes wholesalers who cover extensive trading areas set up branch houses, because of the economy of locating the bulk-breaking point as near as possible to the retail store (carload-lot freight rates are lower than less-

than-carload rates). This gives lower travel expense, closer contact with customers, and speedier deliveries.

Branches are set up so that total operating expenses are at a minimum. The spacing of branches affects the operating expenses. With branches located close to each other, delivery and travel expenses are decreased, while the expenses of maintaining branches are increased. Conversely, with fewer branches located at greater distances from each other, delivery and travel expenses are increased, while the branch maintenance expenses are decreased. What is the optimum number of branches and spacing that will result in the lowest total expense? Note these points:

Better trucks and modern highways make it economical to deliver to greater distances than before

With more economical delivery, the minimum total expense can now be achieved by spacing branches at greater distances from each other. The optimum spacing is, of course, an individual problem for each wholesaler

The increasing importance of *moving* merchandise and the declining importance of *storing* merchandise have affected the number of branch houses and their location as well as on the design of warehouses

The lengthening of economical delivery distances has led to an effort to find the point at which the net advantage now lies—between increased expenses due to the investment in a number of branches and the difficulties in supervising them; and decreased delivery and selling expenses, due to location of branches closer to customers

The savings in expense and advantages of centralization resulting from the elimination of branches may more than offset the additional expenses due to greater delivery distances

Know the territories in which you can operate profitably

It is important that the wholesaler know what territory he can serve profitably. He uses these guideposts:

If he extends his territory too widely he will probably increase his operating cost out of proportion to the volume he can hope to obtain. That dissipates profits realized on the business enjoyed in territory which he can more legitimately serve

If he does not extend enough, he may forfeit desirable trade

A wholesaler's legitimate market embraces all territory in which he can hope to do business on a profitable basis. The boundaries may be closely approximated by comparing the cost of serving each questionable district with the gross profit to be secured from it

If he chooses to serve other than his legitimate market, he might do it by different sales methods

It usually costs as much to prepare orders and keep records for customers in one territory as it does for customers in another. How does the wholesaler go about the study to find which customers are profitable?

- All costs, other than selling and delivery, can be charged to outgoing merchandise on an equal basis, regardless of destination. This burdens all merchandise assembled for shipment with what may be styled a constant cost
- To determine whether a given area in his market is profitable, the wholesaler need only add selling and delivery costs for the area to his constant cost. He then compares the result with the gross profit which the area yields

The wholesaler should continually strive to make each section of his market yield the maximum desirable trade, at a cost which makes operations therein profitable. Cost should be so controlled and activities so adjusted as to make as large as possible the territory that can be served without loss. Some questionable territories may require special treatment.

Before opening a new territory, a wholesaler should first—

- Have the territory surveyed to ascertain the prices at which his type of merchandise is selling in that territory
- Find out what his direct competition would be, where it is located, and what its possibilities are for rendering a better service
- Find out whether competitors operate a voluntary group or whether they have built up a big following on their own brands, whether there is a retailer-owned wholesale house in the territory, and all such information
- Arrive at a determination as to the potential volume of business he feels he can secure from the territory
- Knowing his constant costs and his selling costs, add to these two items his delivery cost in order to arrive at what he can consider will be his cost of operating in this new territory

How mail-order sales can increase profits

The market can often be appreciably extended by employing specialized methods of merchandising. They reach certain areas which cannot be served in the regular way without loss. An example of this type of operation is found in mail-order wholesaling. These suggestions may he helpful to wholesalers entering the mail-order business.

- In no case should a customer who is contacted by a salesman be solicited by mail
- In no case should a mail-order customer be directly competitive with a good customer who is served through a salesman

The mail-order customer should pay the cost of delivery
If feasible, terms should be net, cash in advance
The price sheet is the wholesaler's only contact with the mail-order customer. It should therefore contain all terms, allowances, and discounts in unmistakable, clear language. It should also list all items offered to mail-order customers
Price sheets should be marked "confidential" and any customer using them in a manner injurious to the wholesaler should be removed from the mailing list
Every price on the sheet should remain in effect until either an amendment or a new sheet is mailed out

A prospective customer should be sent price sheets for a reasonable period. At the end of 3 months he should be sent a friendly letter inquiring the reason for not receiving any business, and be informed that he will be continued on the mailing list for a further limited period. Perhaps he has just failed to give any attention to the price sheets that have been sent him, and he is requested to look them over in hopes that he will now find after considering them carefully that he is in a position to favor the wholesaler with a portion of his business. Then, after a further period, he should be sent a final notice that in view of the fact that he does not appear to find it profitable to buy from the wholesaler, his name will be taken off the mailing list at the end of 30 days. If at the end of that time he has not purchased, his name should be struck from the list.

Cash-and-carry outlets can expand sales volume

Many wholesalers have found the cash-and-carry branch a convenient medium. The branch may enlarge their market, expand their volume, and increase their profits. Guideposts to operation are—

Great care should be exercised in the selection of locations for cash-and-carry branches
If possible, branches should be placed at points where they will draw the maximum trade away from competitors and as little as possible from the parent house. This can best be achieved by placing them in localities outside the area covered by the wholesaler's own salesmen
In order to determine the profitableness of a cash-and-carry branch, the wholesaler should make a proper charge for every service rendered the branch
The cash-and-carry branch is most effective when it is geared to handle only fast-moving items which can be stocked in a small area and readily assembled for customers
It should not attempt to stock every item carried by the parent house. In no case where the branch is located in the area covered by salesman

should it carry the long-margin items for which the wholesaler has the exclusive agency and on which he relies for much of his profit

In every case possible, merchandise should be drop-shipped from the manufacturer to the branch. This eliminates several handlings and greatly reduces cost

The prices quoted by a cash-and-carry branch should be high enough to cover all cost plus a fair profit. Any branch which constantly shows a loss should be closed at once

When a new branch is opened in a locality not covered by salesmen, a circular should be sent to every prospective customer in the region. It should remind them of the opportunity offered to secure staple merchandise at low prices. Subsequently, a second circular should be sent to the retailers in the vicinity who are not patronizing the branch

How you can help retailers sell your products

What can the wholesaler do to help the retailer?

First, he can aid in anticipating demand. Since he covers many outlets in the market, he knows which items consumers are buying and which they are not. He therefore is in a position to advise his retailers as to products for which demand is growing.

On the other hand, by reviewing the orders he receives he can sense when the demand for individual items is decreasing and can advise the retailers to close out their stocks of such items before the goods must be sold at a loss.

Other aids are—

He can advise the retailer if the supply of a commodity is dwindling or increasing

He knows when prices on given items are likely to advance or decline. He can indicate to the retailer when it is wise to increase or decrease purchases of the items

He can advise and help his customers with their merchandising and operating problems. His salesmen visit many stores and observe the good practices of the efficient merchants. The salesmen can then pass on these practices to other retailers in a position to adopt them

He can help customers to remodel their stores, put in good accounting systems, establish good credit systems, etc.

He often can obtain for his retailers accounting forms, store fixtures, advertising programs, and other benefits at far less cost than they could be obtained for by the retailers

Sometimes he can maintain showrooms where retailers can bring their customers to examine goods and installations. Electrical appliance retailers can take their customers to their wholesaler's establishment to examine items which the retailers do not have in stock

He can interest retailers in improving their merchandising methods. In

the process, store fronts are often painted, old counters replaced by open displays, interiors decorated, and advertising campaigns inaugurated

He can give retailers price concessions on certain items to meet competition on specials

He can extend credit to his customers in proportion to their capitalization and managerial ability. Without this financial assistance many retailers could not have entered business. Many others could not have remained in business after they were established

He can work out plans by which insolvent retailers can regain a solvent status

When floods, earthquakes, fires, or other disasters destroy retail establishments, he can often advance whatever aid is necessary to reinstate his good customers in business

If the wholesaler is efficient, he has the right merchandise at the right time and at the right price. His warehouse is a stock room from which the retailer can draw goods at the time needed and in the quantities required. This is of extreme importance to retailers in some trades. It helps this way:

In most lines, if the retailers bought directly from the manufacturers, they would have to buy in large quantities. That would necessitate the maintenance of stock rooms larger than their retail stores

Then, too, the nature of the merchandise would add to the cost and difficulty of storing. Some products are heavy; some are light and bulky; some deteriorate rapidly; some are odoriferous; some absorb moisture; some are spoiled by the proximity of others. These commodity characteristics can make specialized storage expensive.

Without this aid, even very small retail merchants would need greatly expanded capital to conduct their businesses. This would prevent the entry into business of many persons of modest means

This system usually offers prompt delivery on small quantities. Then the retailer is not so likely to find himself with substantial quantities of unknown goods which will not sell. He may order unknown goods in "sample" quantities until the demand for them has been established. This enables him to keep his stock fresh and clean, and hold losses from spoilage to a minimum

Trading with the wholesaler instead of directly with the manufacturers reduces to a small chore the retailer's task of buying. It enables him to devote most of his energy to selling. It eliminates:

Need to review, file, and keep posted on catalogues, price lists, price-change sheets, and sales literature issued by the hundreds of manufacturers with whom practically every retailer deals

Direct buying which makes it imperative that the retailer receive, interview, and place orders with scores of manufacturers' salesmen

Direct buying which would materially increase the retailer's accounting

cost. Instead of maintaining accounts with a few sources of supply, he would have to maintain them with many times the number of individual manufacturers

Trouble with adjustments for shortages and errors in invoicing. They are often made on the return call of the wholesaler's salesman. No correspondence is involved. Where goods are procured directly from the manufacturer, adjustments usually have to be made by correspondence, increasing clerical cost and loss of time

One way is to help the retailer fix a pricing policy

One area in which the independent retailer needs help is in his pricing. The wholesaler often has the job of teaching the retailers to do this:

Permit leader merchandising and varying markups on individual items to meet competition

Get varying markups to result in a general average over-all profit rate that will enable the retailer to earn a satisfactory return

Get comparisons to emphasize the fact that high-margin products may, and often do, provide but a small part of the gross profit of the business. Items carrying a small margin may provide a large part of the gross profit because of their large volume of sales

Show how varying margins for various items, some low and some high, will average out so as to realize a satisfactory return. Thus, the retailer's pricing problem will be greatly simplified

All these also point toward a lowering of the wholesaler's operating expenses. He can be assured of a predictable volume for his goods. It can lower his warehouse and delivery expenses. He can know the nature, quantity, and frequency of retailer's orders and can plan operations. It reduces selling expenses because the retailer gives regular, predictable orders. This reduces selling time and cost. It also reduces office expense, billing, recording, and shipping because of larger orders, less frequently given.

Many independent wholesalers have set up a procedure for assisting retailers in pricing their merchandise. Most successful plans urge retailers to gather this cost data:

Gross margin as a percentage of sales by departments. The gross-margin percentage for any item or group of items indicates their relative profitability without reference to the volume of sales

Departmental or item sales as a percentage of total sales. This provides information on the importance of the department or item in the total sales of the company. It is often found that items showing high gross margins are a small proportion of total sales

Dollar gross margins for each line or department as a percentage of total

dollar gross margin. This shows what percentage of total gross margin dollars is provided by various items. This is the figure of greatest importance

Good accounting and inventory methods are indispensable in wholesaler control

All wholesalers are constantly concerned with the dollar margin that will be added or eliminated as a result of a lot of the procedure so far discussed; for example—

Would the business be more profitable with or without a certain group of customers?
Would the business be more profitable with or without a certain group of brands or commodity departments?
Would it be profitable to build a new warehouse building?
Would the business be more profitable with or without certain additional (or presently covered) territories?
Would it be more profitable to purchase with the objective of achieving rapid turnover or would there be a net advantage in larger purchase quantities?

Annual statements of the results of operations and of financial position are of historical interest. But they are not useful in controlling current operations.

Current control demands that far greater detail be available in time as a guide to management. Currently required, for example, are *sales and gross-margin analyses* for use in—

Setting gross-margin rates (prices) on individual items to obtain a satisfactory average gross margin for the business as a whole
Determining the most "profitable" commodities, customers, and brands, from the standpoint of dollar gross margin
Disclosing and eliminating slow-moving and duplicate items and brands
Controlling salesmen by revealing their sales and gross margin attainments (by commodity departments, customers, and brands)

In all methods of making either sales or gross-margin analyses there are certain essential steps. These are—

"Costing" of each invoice to determine cost of goods and gross margins by items or by invoice totals
Transcription and classification of these invoice data by departments, salesmen, or customers
Accumulation of totals and summarization of results

A simple way to get these data is the columnar-analysis method of making sales and margin analyses, which yields sales, cost of goods sold, and gross

margins of individual commodities or departments. The initial step is to "cost" the invoices. The current cost of each item is entered on the office copy of the invoice and extended to obtain the cost of goods. Then it is subtracted from the extended selling price to obtain the gross margin for the item.

Some wholesalers enter only the cost extensions on the invoices. The total cost of goods, and the gross margin (for the invoice) are usually obtained by adding the figures for individual items.

Some wholesalers "cost" each item, but accumulate the cost of goods for the entire invoice. They compute the gross margin only for the invoice as a whole. They do not make sales and gross-margin analyses for each commodity department, but do make them for salesmen and for the entire business.

Where the wholesaler's only interest is in total sales and gross margins for the house and for each salesman, the invoices are first sorted according to salesmen.

If sales and margins by individual commodity departments are desired (either by individual salesmen or in total for the house), a re-sorting of invoice lines by commodity departments is necessary.

One common method is to use a columnar analysis sheet with a column for each department, and to post the amounts of the invoice lines, one at a time, into appropriate columns. The amounts in these columns are totaled daily, semiweekly, or weekly, and transferred to summary sheets. If a departmental analysis by salesmen, is desired, the first step is to sort the invoices according to salesmen, and then to use a separate columnar sheet for each salesman. The sheets for the salesmen are totaled to secure house totals.

Just as important as the *gross-margin analysis* is the real finding of the *profit and loss by customers, commodities, brands, departments, and territories.* This takes an allocation of all the expenses of operations.

Because of the opportunity for increasing profits by comparisons of the costs and revenues associated with small segments of the wholesaler's sales volume, methods have been developed by the U. S. Department of Commerce for allocating unit costs to individual customers and to commodity departments or lines.

Your CPA can readily install these for you with the aid of the booklets issued by the Department.

How to get good inventory control

The low-gross-margin, high-turnover merchandising principle makes it necessary for the wholesaler to have more and better current information about the status of his inventory, for these reasons:

He must determine how much dollar sales and how much dollar gross margin he is obtaining from his various commodity departments, items,

and brands. He needs that before he can successfully merchandise goods through the retail outlets and obtain a satisfactory dollar gross margin for both the retailer and himself

The ability of the wholesaler to operate on a low-cost-per-unit basis requires methods of analyzing and controlling current expenses, as well as adjustments in the methods of physical operation

The innumerable policy decisions involve a choice of alternatives. A wise choice depends upon a comparison of alternative costs and revenues

The inventory is always a large proportion of capital. Its condition affects the efficiency with which operations can be performed. Therefore, every wholesaler uses some kind of inventory control.

How does inventory control help the wholesaler to maintain his merchandise in a condition of maximum usefulness? How does this condition of maximum usefulness affect the efficiency with which operations can be performed? A system of inventory control makes it easier—

To maintain an adequate supply of every item. Data provided by the inventory control are used by the buyer to determine how much to buy and when to buy. The system calls attention to the need for buying when each item reaches the minimum level of stock that has been set

To avoid an oversupply of any item, whether staple or seasonal. The purpose is to increase the rate of turnover. Inventory control discloses slow-moving items and permits reductions of purchase quantities; thus minimum stocks can be set at lower levels

To avoid carrying a stock of items for which there is no active demand. The inventory control, by showing the rate of movement, discloses those items for which there is no active demand, or for which the demand has changed

To detect stock losses by furnishing a "book" inventory figure. The inventory control indicates how much stock should be on hand. By checking these figures with a physical count the exact amount of stock losses is disclosed and data on which to base investigation are provided

Each wholesaler must decide with his CPA what system of inventory control will be most satisfactory for his business.

While there are many variations of detail, the inventory-control systems fall in three classes: (1) observation methods, (2) periodic stock-count methods, and (3) perpetual inventory control.

The ideal inventory-control system furnishes a measure of the actual amount of stock on hand of each item, and its value, at any time. It also shows the rate of movement, or sales, of each item.

In using any type of system the problem of the wholesaler is to obtain accurate information currently. With some of the simpler systems, it is scarcely possible to do so.

The advantages of the three inventory methods can be detailed this way:

1. The *observation* method is the simplest and least expensive. As a general rule, it is the least satisfactory. Heavy reliance is placed on judgment and memory. There is no record of the rate of movement or of the quantity on hand of any given item. Stock standards, such as minimum- and maximum-stock points, ordering points, and economical purchase quantities cannot be set. In using the observation method there are no data on which to base such standards. It is not really an inventory control.
2. The *stock-count* method is an improvement over the observation method. It furnishes some indication of the rate of movement, as well as the quantity on hand. It also furnishes a written record of the wholesaler's experience with any item. It is relatively simple, inexpensive, and flexible in its application. The opportunity for error, the lack of data between counts, and concealed errors in the calculated rate of movement are the principal disadvantages.
3. *The perpetual-inventory-control* method furnishes the most complete information. It does cost something to operate. But the cost is moderate in view of the controls it gives.

With the perpetual methods of inventory control a detailed record is kept (in units) of every item of merchandise handled. Values may also be determined at any time by multiplying the number of units on hand by the average cost or other cost per unit.

The data for each item in stock supply a continuous record of purchases, receipts, sales, and returns. They also give a continuous balance of the quantity on hand, and also values, if desired. Thus, a perpetual inventory control provides current data of stock on hand, without the necessity of making a physical count, and current data on the rate of movement, for each item.

The rate of commodity movement is obtained by posting daily sales, in units, from customer invoices. A continuous record of the stock on hand of each item is obtained by means of the following formula: The previous inventory (units), plus receipts (units), minus sales (units), equals the quantity on hand (units). This "book" inventory figure represents the quantity which should be on hand. These data are checked periodically by a physical inventory. Differences are investigated.

A perpetual-inventory-control system makes it possible to establish certain standards for each item in stock useful in controlling inventory and purchasing activities. These standards are—

Order points, which indicate when to buy
Maximum- and minimum-stock standards, which are safeguards against "out-of-stocks" and "overstocks"
Standard-order quantities, which indicate how much to buy

The order point will be based on the average time lapse that occurs between purchase and receipt of the merchandise and on the maximum rate of sales during that interval.

Sufficient stock must be in the warehouse at the time of ordering to avoid the occurrence of out-of-stocks before the new goods are received. The minimum stock, which represents a margin of safety against out-of-stocks, can be computed by subtracting the average sales during the period of time required to fill an order; from the quantity established as the ordering point. The maximum quantity of stock, of course, is the maximum old stock expected to be on hand when a new shipment is received, plus the standard-order quantity.

Wholesalers use perpetual inventory to reduce the amount of inventory carried. That results in opportunity for expense reduction. Purchasing fast-moving merchandise in smaller and smaller quantities in order to achieve a higher turnover rate may merely result in increased buying, receiving, and other expenses. It may give higher cost of goods, and increased risk of out-of-stocks, without compensating advantages. To reduce expenses and to increase profits, as a result of higher rates of merchandise turnover, this specific action is required:

A reduction in the amount of space used for storing inventory or a reduction in the financial charges on the investment in inventory (interest, insurance, taxes, etc.) Since space and financial charges are semifixed costs, they can be reduced, if at all, only as a result of significant reductions in inventory

An elimination of slow-moving items in stock and replacement with other goods having a higher turnover rate. Since the dollar costs of financing and storing the total inventory will be little affected by such a course, the increase in dollar gross margin should leave larger net profits

An increase in sales volume without proportionate increase in inventory. That will result in obtaining a larger dollar gross margin without increasing the finance and storage expenses associated with inventory

The operation of an inventory-control system often discloses many slow-moving and duplicated items which can profitably be eliminated. An expense reduction, however, does not always follow automatically. The expenses of financing and storing merchandise in stock are semifixed in character. A reduction in the amount of stock may furnish an opportunity for reducing expenses. But management must act to take advantage of the opportunity.

13. HOW TO OPERATE A BUSINESS OFFICE MOST EFFICIENTLY

Be sure your building is the best you can get for your needs and your pocketbook. Locate where it will do you the most good. This means that you should—

Be accessible to transportation systems for employees and customers
Be near to customers and clients served, your bank, post office, warehouse, and factory, and sources of labor and material supply

And then check—

Restaurants in the immediate vicinity?
Neighborhood free from excessive dirt and noise?
Similar business firms in same locality who may be desirable?
Neighborhood such that employees have no fear passing through it?

Check to see that your activities are not affected by local zoning restrictions and building code. You ought to know the comparative cost per net square foot of usable space, giving due weight to various service costs, against what other buildings can offer you. Compare the facilities of the building with what others have to offer, particularly—

Services provided by the building—elevator, heat, sanitation, janitor service, light, toilets, window shades, fire protection
Floor available, considering elevator usage
Exposure available, especially if east or north light is needed for your work
Space available for possible expansion. Consider securing options on more space or leasing more space than you require at present. You can sublet part of your space on short-term basis until the need for additional space arises
Shape of office space available—rectangular shape will require much less walking than a long, narrow space. Check on height of ceilings
Number of electric outlets available

How to lay out an office

First, consider the space requirements of all equipment. Then find the requirements for your people and services. Some standards have been evolved in practice. They are—

Aisles: important ones up to 7 feet; others 3 to 5 feet
Offices: minimum 9 by 14 feet, with averages of 12 by 15 for one person and 12 by 18 for two
Space required for each individual: an average of 100 square feet per person, including space for executives and foyers

Get proper facilities for reception room, conference room, storage, and vaults. The reception room should be 10 square feet per person, for the maximum number of people who may come at one time, and a minimum size of 50 square feet.

Study the need for rest rooms, coatrooms, and any other provisions for personal comfort. Be sure the building provides adequate toilet facilities—one toilet seat for every 15 persons; one washbowl for every 20 persons; liquid or powdered soap, individual pull towels or paper towels, and mirrors, especially in the women's room. Try to make it provide for adequate drinking-fountain facilities.

Seek to allot your natural light, noiseproof rooms, and best ventilation for greatest efficiency. Give others artificial light.

In employing partitions, consider the height and type to be used, based on requirements for soundproofing, light requirements, air circulation, movability with office rearrangement, and possible use of walls for business purposes.

Study the ventilation. Consider the need for equipment to maintain constant temperature, avoid drafts, and circulate plenty of fresh air.

Now you can make a layout plan with cardboard templates:

Place desks and equipment so that the light from windows will be at the left of the individual
Strive for straight-line production for smooth flow of work
Place those that must meet the public in an accessible spot
Separate people handling funds, to get maximum control
Place desks of people doing related work as near to each other as possible
Bring people frequently communicating with each other close together
Place executives near the departments they supervise

Consider the disadvantages of private offices: They complicate the problems of ventilation, lighting, and heating; decrease amount of light and air for other employees; waste space; are costly to build and equip with furniture; require additional telephones and buzzers. Use them only when the dignity of the position requires it; when they are essential for greater concentration, or to avoid distraction to other employees by frequent callers.

Be sure you have adequate *lighting* in the office. Poor lighting means eyestrain and tired and grumbling employees. Fatigue can be reduced by better lighting. Compare your existing light with accepted standards by use of a light meter. The electric company in your vicinity will aid you willingly in

your study. You ought to know the accepted standards for the light meter for office work. They are: ordinary desk work needs 20 foot-candles; close work 30 to 50 foot-candles. The quality of artificial lighting is important in order to avoid glare and shadows and to increase diffusion. Study available equipment to secure fixtures that will properly direct the light. Glass-top or highly polished desks cause glare. Blotters and desk pads will absorb light and tone down glare. Avoid too great contrast of light in different parts of the same room. Consider use of indirect lighting and translucent bowls to increase diffusion of light.

Efficiency of lighting may depend largely on getting maximum reflection from ceiling and walls. Flat white is the most satisfactory color for the ceiling, while flat white paint on the walls may reflect up to 90 per cent. Buff, light blue, or green will reflect about 60 per cent. Blue and green paint are frequently used for side walls to soften glare and because they make the room appear larger.

Control of lighting fixtures is essential for economy. Use a pull cord or other arrangement to permit elimination of light when not needed. Also, place notices at strategic places, reminding employees to extinguish lights. You will also get economy if—

You keep ceiling and walls clean. (Walls with smooth finish are easier to clean than those with a rough finish, but an enamel finish tends to cause glare)
Replace or repair defective reflectors
Use the proper size of lamp
Dust lighting equipment regularly
Clean reflectors and glassware periodically with solution of ammonium carbonate and then rinse with warm water

Think about office *noises* when you make your layout. Will they seriously interfere with the concentration any employee can give to his work? You should study ways to reduce noise from office machinery, conversations, and outside sources. Isolation of noise-producing equipment in soundproofed rooms is advisable. Other ways to reduce noises are—

Silent-type machinery is advisable if it can be obtained
Partitions and ceilings may be treated with sound-absorbing materials
Carpet over Ozite cuts foot-traffic noises
Acoustically treated rooms give lowered noise from voices
Linoleum and cork floors, linoleum table tops, and muffled telephone bells will help eliminate noise
Oil on doors, drawers, cabinets, swivel chairs, and other equipment will lessen noise
Direct education of persons who talk or dictate too loudly may help considerably

The best room *temperature* is 68 to 70 degrees. In considering ventilation, partitions that greatly restrict air circulation should be removed, and smoking should be confined to private offices and rest rooms. Installation of air conditioning might be desirable.

What equipment should you have for your particular office?

What considerations should lead you to buy equipment or office machinery? You should buy new, or even secondhand, equipment only if your studies show that it will—

Speed up work
Simplify record-keeping operations that are enormously complicated
Economize on office space necessary to handle records or work
Make your records more durable
Afford protection in handling of your cash, securities, mail, and other office details
Save the time of executives and office workers
Make records easier to find
Make the office more livable—particularly in proper ventilation, heating, and lighting
Avoid loss of records through proper filing, stapling, registering, and similar procedures
Make it possible to get your records and statements more quickly through accounting, calculating, and similar machines
Cut down problems in office work by speeding the preparation of complete statements
Sometimes cut down employee costs by use of automatic equipment
Avoid clogging of your files, as by use of transfer cases
Permit economical use of supplies by current substitutes for timeworn methods
Cut down bulk in books and in storage space
Secure permanency of records through photographing and similar reproduction methods
Effect neatness in record keeping through typewritten rather than handwritten records
Cut down writing space by using machines that space the writing
Avoid disintegration in records and files by special treatments
Promote greater accuracy through machine calculation

Know the job you want to do when you buy equipment. Or else, get an expert to show you the economies possible. The advice of office-appliance and equipment dealers handling the type of product you want to install is often invaluable. Ask them to give you detailed studies of the appliances, showing how their installation will affect your operations.

Avoid the normal mistakes made in acquiring office appliances:

- Failure to recognize that specialized help like that of your CPA is sometimes necessary
- Acquiring equipment that is not of the same standard as other equipment in the office—lack of uniformity
- Purchasing equipment the use of which, though advantageous, is confined to short periods. Machinery is often acquired in the hope that it can be used more extensively
- Failure to consider the space available for installation of the equipment
- Failure to consider noise and other working conditions that will result from some installations
- Failure to consider personnel problems that may arise as a result of installation of automatic equipment
- Failure to use equipment for the purpose for which it was purchased. Too often it is bought for one use and then converted to another

Know what office equipment you have *and what it costs to maintain.* A good idea is to keep a record of each piece of equipment, showing the manufacturer, serial number, model, cost, date of purchase, type of work performed, location, etc. Then provide for recording the maintenance costs, perhaps on reverse side of the record card. Show the dates of repairs.

How to maintain office equipment at the lowest cost

Make sure you do everything to keep office equipment in good condition. Here are some normal practices that cut costs:

- Care for seasonal equipment (fans, screens, heaters). Store them in a dry place after thorough cleaning and repairing
- Oil the casters under all chairs at least once a month
- Give varnished surfaces a good cleaning and oiling once a month. Ink will generally come out of furniture with linseed oil and wax after moderate sandpapering
- Clean linoleum tops weekly with oil, wax, or even sandpaper. Linoleum floors should be treated regularly with a thorough scrubbing with soap and water and then a rubbing with wax
- Clean your lighting fixtures regularly. Dust them daily
- Ask employees to report defects in desks or equipment quickly so that repairs can be made before it is too late
- Investigate the service job offered by all reputable equipment people. They will make annual contracts on a reasonable basis even though you did not buy the machines from them

Ask your equipment suppliers for a list of things to do to help keep your office machines in good service. They are anxious to have you keep using the machines. Make sure employees using machines thoroughly understand how

to operate and care for them. Machines must be serviced by trained mechanics. They ought to be kept covered when not in use. Give operators these points, too:

Remove all visible dirt, taking care not to unlock springs
Remove lint from multigraphs, multiliths, addressographs, and other duplicating machines
Oil fast-moving machines regularly and carefully; use good grade of medium-weight oil, not a light oil
Change cloth ink pads at least once a month
Wash ink off rollers when machine is not in use
Wash impression rollers with soap and water before the ink dries
Don't try to force too much speed out of machine
Never force or bang the machine
Never use cleaning fluid on rubber parts of machines
Don't allow the motor to idle; remove plug from wall when machine is not in use
Be sure you understand the operation and care of machines; keep instruction book handy

To get maximum use of your typewriters, make a survey of the extent to which the machines are used. A simple time study may be of great value. Perhaps you want to make necessary rearrangements to get maximum use by—

Staggering of lunch hours
Staggering of dictation and typing time
Sharing of machine by secretaries

See that typists take good care of their machines. They ought not to pound the keys harder than necessary; a smooth rhythmic action is faster and less wearing on machine and operator. And other suggested rules to give these are—

Do not slam the carriage back
Never force a movement if something jams
Pull carriage to one side when erasing to prevent particles from falling into machine
Use at least two sheets in the machine at all times to safeguard the platen
Keep a felt pad under the machine to absorb vibration and prolong life. The supporting desk or table must be firm; fasten machine to support if possible
Keep machines covered at all times when not in use
Have oiling done by a mechanic (once a week is enough); he should oil only the carriage rails, using a light-grade oil
Lift machine at bottom, not by carriage
Never use force in changing ribbons
Clean machine thoroughly at the beginning of each day

Keep the typewriter type faces clean at all times. To do that—
- Cover the platen and ribbon to avoid damage
- Then place a drop of good solvent on type faces and allow a minute or so for it to penetrate

Now brush carefully, using a brush with soft, firmly fastened bristles
Avoid brushing particles into other parts of the machine
Remove any caked particles with a sharp-pointed piece of wood or toothpick. Never use metal, which will scratch type faces
Wipe slugs individually with clean, fresh rag

How to cut your costs for printing, paper, and engraving

Greatest economy in dealing with printers comes from being familiar with the range of work most economically handled by them. Invite bids only from printers who are properly equipped. They will ordinarily be able to turn out the work at the best price.

Seek the advice of the printer, before planning a job in detail, as to size, style, paper, folding, and mailing. And watch these money-saving ideas:

- To avoid trimming, with resulting waste, know the various standard-size papers carried in stock by a printer
- Work out a schedule of low-volume periods at the printer's and print your stock forms during this period if you can get a saving
- Work out a schedule to permit you to run several of your jobs as groups on larger presses. That may cut costs
- Check the printer for improvements in copy preparation that would help him to interpret your desires, permit him to secure better production, and eliminate costly corrections
- Weigh the advantages accruing to the job against the cost, whenever you consider the use of extra color, tricky layouts, bleed or oversize pages, excessive corrections, holding presses, or running into overtime
- Make sure you are receiving the benefit of lower prices that can come with increased press runs, simplification of layout of text matter, change in size of type, etc.
- Don't pay for rush work that can be avoided by planning in advance

Cooperate with the printer by releasing forms on schedule if you want your work out on time. Don't put the entire responsibility on him without realizing the need for cooperation. Allow him enough time to do a satisfactory printing job. You can do this if you understand all the elements that go into production. Find out if you can curtail costs by reducing the number of galley, page, or press proofs furnished at your request by the printer.

In the control of your *composition costs,* give the printer clean typewritten copy. Review it (edit) to avoid later corrections and thus keep down costs. And maintain this routine:

Don't send copy to the printer to be set long in advance of publication date. You might find that a change in events did not permit you to use it

Develop a method of measuring space requirements for given copy in advance, or use a copy-fitting system to avoid overset matter or revisions to a smaller type size in order to fit space available

Cut tabular costs by having the line cuts made after typewriting or varityping

Find out if you can save by changing to fewer columns per page, or selecting a face that can be set by a slug-casting machine

Consider the selection of a type face that may be larger on the same point body, to give the equivalent readability at smaller composition cost

Be familiar with all the type faces available at your printers. Utilize them in place of costly hand lettering and engraving

In control of your presswork and binding, be sure you ask the printer for imposition charts. They permit economical layout of various size forms on the printer's equipment. Give the printer larger forms if it will save money on his equipment. And use these ideas:

Run large color forms, and slit or cut them into smaller units for binding into different parts of copy to spread as required by special positions

Lay out your color pages to permit printing of several colors in the same form by use of split rollers

On color pages, be careful to send to your printer, in advance, a specific sample of color on your own stock if possible, so that he can arrange for that color, before he is ready to run. Some colors require considerable time for proper matching

Consider the use of gloss ink for covers, in place of varnishing, thus saving press impressions

If you use covers for house organs or catalogues requiring tint blocks of a specific color, see if you can cut costs by running them in larger forms, several up, for a number of issues at one time

If you imprint from electrotypes, check the feasibility of running from type and saving foundry charges

Do you pay for unauthorized overruns? Why?

Make someone in your organization responsible for incurring charges for holding up presses or overtime

When planning your press layouts, provide for machine gathering of inserts between signatures when possible, rather than have them inserted by hand owing to their position. If gathering is impossible, try to insert in the middle of the signatures, since other inside positions usually require slitting of the sheets and extra expense

Check the possibility of binding 32-page signatures instead of 16's, or 16's instead of 8's

Consider saddle stitching in place of side stitching if your book runs less than three signatures

Bind your job with fewer staples; for example, two instead of three. This helps your printer conserve essential supplies

Give a printer your print order early enough for him to cut stock and arrange other preliminaries to avoid last-minute delays

In control of *paper* you use, do not buy paper from the printer (and pay him an extra service charge) if you can help it.

Consider the use of cheaper papers—for example, machine-coated instead of regular-coated stock in view of the lower price; or the use of lighter weight stock to save money on paper and postage. Do this, too:

Have the printer report damaged stock to you

Maintain detailed perpetual inventory records to know what stock is really used

Check paper consumption and waste allowance independent of the printer's reports

Make him credit you with offcut that can be used for other purposes

Before using a new kind of paper, consult your printer as to its suitability. Determine whether your presswork cost or your schedule requirements may be affected by the change. Test it also for qualities you need, such as fineness, smudging, opacity, erasability, pencil surface, and endurance

Request your printer to trim to exact specifications

Limit the sheet size of your paper stock to a minimum of trim waste

If you are printing bleed pages, consider varying sizes of paper stock for the bleed and nonbleed forms. You can save some money on the nonbleed by a smaller sheet. Don't run all forms on the larger sheet required by the bleed forms

In your control of *engravings,* study the economy possible in grouping of several pieces on one copy for reproduction for the engravers. Check these points, too:

Some photographs and some retouchers' paints are likely to contain traces of blue or brown or a yellowish cast. It may result in poor engravings, the blue coming light and the brown or yellow going dark. The need for pure blacks, grays, and whites is frequently overlooked and is likely to result in expensive makeovers

When you have colored copy from which a monochrome engraving is to be made, consider the possibility of having a commercial photographer make a color-corrected copy negative and print—rather than pay the engraver's "emulsion negative" charge

Find out who is cheaper on mortices, notches, etc.—your engraver or your printer. Often the engraver's work of this nature has to be done again by the printer. The engraver may not know just how you are going to use the plates. Find out if you can save by having the engraver trim one or more edges of a block flush, rather than pay the printer for this work, when it is necessary to accommodate a caption

When expensive plates are to be run for a long period, electrotype them to avoid the need for remaking originals later. Originals are likely to crack at the edges and in other places with repeated runs

Some printers require unmounted engravings. Check with your printer. Determine if you can furnish him with unmounted plates and save the cost of mounting

Are too many of your plates ordered for rush delivery? Remember that, if the engraver or other supplier is given more time, this might help to reduce your price. Or at least it gets less confusion, makes for greater efficiency, and enables suppliers to plan their work better

Maintain records of all printing to secure information for reduction of costs. That planning helps you to reduce costly corrections, eliminate frills, and intelligently estimate future costs. Factors to watch in your record study to decrease costs are—

Decreasing the quantity of killed matter
Comparing costs with those of others
Reducing the number of copies printed
Decreasing the use of bleed and other tricky forms
Improving scheduling to eliminate overtime
Avoiding delivery of late copy
Making larger purchases, resulting from precise knowledge of requirements
Reducing the allowance for waste on part of printer
Changing texture or finish of paper
Decreasing the sheet size for trim requirements

How to get the best design for the forms you need in your business

When you design the forms you need in your business, be sure each form: clearly indicates its purpose; commands immediate attention; and provides a place for the date. And be sure each form—

Records items in the same order, if the form is to take information from or pass information to another form

Has its information in the relative position in which it will be used or posted by the person receiving it

Has all recurring items printed so that only variables need be filled in

Carries its most important items in a prominent place where they will be seen quickly

Contains space for numbering or coding, to facilitate filing and re-ordering

Will fit typewriting or handwriting operations

Where possible, uses exact spacing for required information to eliminate use of unnecessary words

Has a margin on the form so that it will not have to be rearranged later

Will fit window or other envelopes you may use

Makes use of tabulator stops on the typewriter to save typing time. Have

the printed material aligned on the right-hand side rather than the left
Differentiates revised forms so that they are distinguishable from the originals
Makes full use of combination forms and carbon copies where possible
Makes use of different colors to aid in identification and reference and to ease eyestrain
Is the correct size for filing or binding
Is printed on the size and weight of paper that is most economical

Buy your paper to fit the specific needs you have for it. That means buying—

13-pound where five or more copies are to be prepared (13-pound paper means that 500 sheets of standard mill size, 17 by 22 inches, weigh 13 pounds)
16-pound where one to four copies are to be made
20-pound for letterhead and forms sent to customers
24-pound for ledgers
28-pound for special ledgers, legal documents
Tissue grade when many copies are to be prepared
Bond paper when a single form is prepared with pen or pencil or typewritten on one or both sides
Ledger paper for permanent ledgers prepared by pen
Bristol board for card records used frequently

Consider the length of time the form is to be used and get the paper for your particular purpose. For example—

Years to be kept	*Type of paper needed*
1 to 3	100% sulfite
3 to 6	75% sulfite, 25% rag
6 to 10	50% sulfite, 50% rag
More than 10	100% rag

Set up a routine for checking forms periodically. Make sure the person initiating changes knows printing, paper, and mailing economies. Have him review forms to find—

What is essential?
What can be cut out?
What is duplicating other effort?
What use is made of the copies prepared—are they unnecessary frills?
What combination of forms can be made?
Can more copies be made at one time, if copies are necessary?
What writing on it can be eliminated by checking or crossing boxes?

Help his studying to find out if some forms can be eliminated or consolidated with others. Have him determine if any form is wasting more time to keep than the record is worth.

Be sure to check the rough sketch of any new form with the actual users,

for possible changes, additions, or eliminations. This helps in purchasing; facilitates regular review.

Before giving the job to a printer, consider whether it would be more economical to reproduce the form yourself, using mimeograph, multigraph, ditto, or other duplicating devices—or can you use a rubber stamp for intra-office forms?

How to keep stenographic and correspondence costs at a minimum

Find out if you should cut full-size letterheads in half, or reduce the size of letterheads to 5½ by 8½ inches and type across the short dimension. Consider cutting carbons to the same dimensions and reducing the size of tissue copy.

Can you use unskilled boys or girls to prepare batches of letterheads with carbons and second sheets, to save time of typists? They can also separate them after typing.

Should you prepare envelopes in advance to companies and persons to whom you write frequently? You can address them by a duplicator and set them in racks to be used as required. Other points to watch are—

Can you use window envelopes to save writing?
Can you make your copies on the back of incoming letters instead of using carbons or second sheets?
Is it advisable to use government postal cards to acknowledge letters?
Can onionskin or thin letterheads be used?
Are you reusing interoffice envelopes as much as possible?

Check to see if those who dictate letters are wasting their own and the stenographer's time.

Be sure they prepare dictation in advance by reviewing previous correspondence, planning each letter, perhaps in outline form, consulting others in advance when necessary, and having all necessary data at hand. Arrange a definite dictating schedule, preferably at the same time each day.

Consider the stenographer and her work. Help her do her job more efficiently. To do that, tell those who dictate to—

Enunciate clearly; don't swallow words or phrases
Spell out all technical terms and proper names
Speak at a steady speed in a natural, conversational tone; avoid spurts, silences, and monotones
Keep all distractions (mannerisms, smoking, telephoning, etc.) to a minimum while dictating

Consider the economies of manuals and form books. In them, you write up the system for the guidance of all concerned. You also do this:

Standardize methods and forms of correspondence as much as possible, without sacrificing efficiency and the personal touch needed in customer relations

Incorporate in your manual of procedure definite instructions for abbreviations, salutations, closings, indentation, spacing, punctuation, etc.

In many cases, prepare form letters or form paragraphs selected from previous correspondence, which represent matured judgment and are much better than haphazard dictation

- Speed in the production of letters is aided by form paragraphs
- The monotony of answering a great quantity of similar correspondence is avoided by using form paragraphs or letters
- If used, the forms must be carefully prepared

Your stenographer can cut mailing costs by eliminating unnecessary waste in sending out stamped, self-addressed envelopes with collection letters or statements.

Don't dispatch special-delivery or air-mail letters too late. If they are held until late in the day, the extra postage is frequently wasted. See that all the office mail going to one person is placed in one envelope.

Accurately weigh all outgoing mail to avoid too much or too little postage. and watch these postage cost-cutting hints later in this chapter.

Be sure your typists are familiar with all the timesaving "tricks of the trade." One is in addressing envelopes. Experts eliminate waste motion by turning carriage down and inserting new envelope beneath flap of the old, continuing to reverse the ordinary turn of the carriage. In centering a caption, they find center and then backspace once for each two letters.

In typing columnar figures, they insert sheet with its left edge at zero on the scale. Then they divide the scale figure at the right edge by one more than the number of columns you want, and place the tabulator keys at multiples of the answer. Thus, if five columns are needed, and the scale reads 90 at the right edge, divide by 6, then place tabulator stops at 15, 30, 45, 60, and 75. This gives even spacing.

Other ideas are—

To draw a vertical or a horizontal line without removing the sheet from the machine and using a ruler, place pencil or pen point at typing line, wedge firmly, and move carriage across for horizontal line or turn cylinder for vertical line

When rush work must be done immediately and a letter is half done in the machine, pull carriage down to letterhead, insert new material, block carbons, and type new material. This avoids taking the half-finished sheet out of the machine, then reinserting it later, with realignment difficulties

When mail is sent to branch offices daily, have operators address a supply of envelopes or stickers during slack periods in the department

If this is done, keep the addressed envelopes in alphabetical order so that they are immediately available

When you buy furniture for a stenographer, pay a lot of attention to cost cutting and turnover.

Get desks and chairs that give maximum desk comfort at a natural working height (about 29 inches) and allow greater desk usability for the person sitting. They should have adequate drawer space and compartments, card racks, stationery racks, accessory racks, letter trays, and letter work file and partitions for the particular job to be done.

They ought to permit sitting in scientifically correct posture to eliminate "afternoon tiredness."

How to control office filing costs

Cut your costs by making sure that your filing system locates documents instantly.

To do this, you must be sure you have the most economical basis for indexing, sorting, releasing, finding, following up, and transferring.

Study, first, your whole folder arrangement.

Allot to each folder a specific, inflexible place in the files. Seek to make material easily found by grouping folders naturally, by means of proper labels and guides. Keep individual folders for active names, but give inactive files special treatment.

Treat all matters on individual names or individual subjects in one folder. Put the newest addition to the files on the top. Divide the folders when they become heavy. Give specific directions to the content of folders, particularly as to the number of papers to be inserted in each. Control folders out of file through cards listing those removed.

You should study the system available to you. Select the one, or combination of several, most suited to your needs.

Alphabetical filing has these advantages:

Most appropriate where the volume of correspondence and other filing is small
Simplest and least expensive
Unnecessary to create special folder for each correspondent
Personnel require no special training
Papers misfiled will not be too far from correct place

But it also has these disadvantages:

Variations in spelling make chance of error very great
Inexperienced clerks often fail to follow dictionary arrangement
Room for expansion in each drawer must be provided, making additional equipment necessary

If you do use an alphabetical filing system, give it a chance to operate properly:

Use card files that break the file up alphabetically, so that the clerk quickly finds the folder
Have separate folders for most active names
Use given, or first-name, separation folders when this is necessary
Separate recurring names by appropriate territories
Have appropriate guides to signal recurring names
Divide bulky folders chronologically (one folder for the first 6 months, another for the last 6 months, etc.)
Divide some name folders according to subjects dealt with, where it is necessary

A *subject filing* system can be used when the arrangement by subjects is important—for example, for matter pertaining to one case or contract. This method can lead to great confusion unless the subject arrangement is worked out long in advance. Overlapping of subjects must be avoided. Only one person can select the titles, and cross references must be maintained.

In a *numerical filing* system, your papers—invoices, contracts, orders, etc.—can easily be numbered and cross-indexed. The code can be used for other purposes; for example, to furnish a complete list of customers. You have secrecy as to contents of files; only a number appears. If you have a difficult transfer-filing problem, transfer files are always best handled on numerical systems. That prevents rehandling of boxes with each transfer. If you adopt this system—

Use card index, cross-indexing by name or subject matter
Make sure every paper bears your filing number
Use a separate consecutive folder for each number
Use a folder and guide arrangement to give perfect visibility for quick handling

A *geographical filing system* ought to be used when there is a large volume of correspondence that should logically be kept together on the basis of localities—for example, sales work where the community is the chief factor. Give the system the best possible equipment. Go at it this way:

Find the geographical divisions of importance to you (states, counties, towns, streets, etc.)
Then create card and signpost guides that will quickly get you to the correct folder
Break up folders (as in the alphabetical filing) into—
  The important names, recurring subjects, etc.
  Chronological folders for any bulky names
  Subject matter within important names

A *chronological filing* system can best be used for filing creditors' bills by discount dates or for filing of letters according to date of receipt or date when some action will be taken. It is most practical for use: in collecting bills; in follow-ups; and in other matters where the date is the controlling factor.

Consider the use of more modern equipment and supplies for filing. Get burglar-, fire-, water-, and bombproof equipment if you can. Don't buy any size of cabinet. You can get special sizes of files and guides to fit your checks, cards, invoices, ledger sheets, folder documents, blueprints, etc. And do this:

When space is important, consider using five-drawer letter files instead of the customary four-drawer ones
Know the advantages of a preliminary sorting of papers before filing, through sorter trays and tickler systems of various kinds
Study the economy of various forms of cross-reference cards sold by most equipment houses, with a view toward avoiding making many copies for various parts of your files
Study the types of charge cards that are used again and again to record material taken out of files
Consider using special carrier folders when material is taken from the files to help ensure an early return
Study your current supplies (guides, folders, and accessories). Your equipment dealer has many economies in these to offer. Get those which give the greatest durability and permit the greatest finding speed

Your method of transferring material from files should be the cheapest from your point of view. Consider these three methods now being used for transfer work:

Regularly transfer the entire contents from current files to transfer boxes
Regularly transfer out of current files only the material over a given age (say 1 year old) to transfer boxes
Maintain two sets of filing cabinets; use the upper row of drawers for current files and the lower for transferred documents. This expedites reference to recent files and material not recently transferred. At fixed periods transfer the old files to storage

Make sure your transfer file is numerically arranged. Any other method results in confusion. But always maintain a cross index of materials in transfer files. Make sure your transferring is at fixed periods.

File promptly so that work does not pile up—so that papers are found where they should be. Make sure filing is done daily so that material does not accumulate. And do this:

Make sure that papers are placed with the head reading from left to right so that it can be easily read in the files
Insist that file folders be taken out before the paper is inserted, in order to preserve the files

When folders are full, use expansion folders or divide folders; this will conserve supplies

Insist that folders taken from the files be returned as soon as possible

If you are having difficulties, consider making it a rule that all outstanding records be returned to the files at the close of each working day; then every morning have such records as may be required redistributed to the proper desks without unnecessary calls on the filing department

When the records are outstanding for more than the usual length of time, keep track of them through the use of a tickler system

Examine the contents of file drawers occasionally to see if all papers are worth saving. Preserve material with a limited life of usefulness for a limited time (say 3 months)

Don't fill file drawers so full that papers cannot be removed easily or without pulling out unwanted material

Study the method by which papers are fastened in your files. Inquire whether pins, clips, or other fasteners are essential. Consider the use of perforators that fasten papers together by hand machines; pasting related papers together.

Establish and adhere to a time schedule for the retention of records in the files. Clean out the files regularly. Organize the transfer system carefully. Appoint someone to work out the procedures and be responsible for the follow-up. Work this way:

Classify what is to be destroyed and what is to be transferred. Decide how long various types of papers and records are to be kept

Recognize that filing affects a good many departments and people with differing views and requirements

Survey what is being filed. Make arrangements to eliminate putting into permanent files unnecessary duplicates that may come back to the filing department from several departments. Decide which copy to keep—preferably one of distinctive color

Set up a routine for automatically disposing of purely current carbons after some established interval has passed

Mark on the copy, at the time written, the date for its disposal. Have the filing department work through the folders as they file and take out material from the back

Consider transferring your records to microfilm. Records on film result in enormous saving of filing and storage space. A roomful of records can be condensed to small rolls of film occupying a small fraction of the space. Other aids are—

The rolls can be safely stored in bank vaults or another place of safety

Records can be fireproofed and dustproofed easily

Film binds the records in a definite, unchangeable order

Loss of a record in a group is impossible; a page cannot slip out accidentally
Fraudulent alteration of records is avoided
Postage savings in mailing records can be substantial
Transportation and transfer of records is easier and more economical
Old paper records can be shredded after filming and sold as scrap

Be sure of the conservation of the filing materials. Reuse file folders and guides. The reverse side is often adequate. Use the backs of 3- by 5-inch cards. Salvage the material weeded out of files. See if there are filing materials in the dead file that can be put to use in the live files.

How to cut your postage costs

Get someone at the post office to tell you all the postal rates for each class of mail. They do it gladly. And you will get great economy if you know the many services available and how to apply them for your benefit. Most small businessmen do not know all the post office will do for them.

Investigate mechanical helps to see if they will save you money and time in handling. They include—

Hand stamp affixers, which pick up, moisten, sever, attach, and count stamps
Envelope openers
Sorting racks and tables to facilitate sorting and dispatching mail to various departments
Folding and inserting machines
Addressing machines
Postage scales
Parcel-post machines
Scaling machines
Combined sealing and stamping machines
Metering permit machines
Nonmetering permit machines
Tying and bundling machines

Review carefully the chance in your place for the mail frauds that occur so often in small business offices. Then consider using a process of metered mail, or precanceled stamped envelopes, or stamped envelopes of any other nature. See Chap. 3 for the story on this.

Check your office routines on normal wastes in any office. Go at it this way:

See if your people are mailing two or more letters to the same person in one day when they might be sent in one envelope
Avoid use of clips or other weighty material in your mail, to cut the cost
Don't store envelopes in a warm, dry room. The gummed flaps may curl and make sealing difficult. A shallow pan of water placed above each tier of envelopes provides sufficient moisture to prevent drying out

Make sure you weigh your mail—it's cheaper than counting it

Be sure outgoing mail is collected early enough so that it can be properly weighed and stamped—a last-minute rush by the office boy may mean careless and excessive stamping

Put a distinctive marking in the upper left corner of your envelope—invoice, statement, order, etc. This speeds sorting in the receiving office and delivery to the proper office division

Don't use air mail to points served as quickly by first-class mail

Charge stamps to the department sending out the mail—a report at stated periods on the postage ordered causes them to be more careful

You need to watch many details to cut your costs in your mailing. Check these points:

If you want an envelope to hold not more than 1 ounce, you need not necessarily confine the contents to one sheet. With some lightweight paper, especially useful for air mail, 9 sheets weigh only ½ ounce

Large first-class envelopes should be clearly marked or stamped "first class"; otherwise, they may be mistaken for second-class mail and delayed in transit

Instead of enclosing stamped, self-addressed envelopes for reply, business reply cards and reply envelopes permit you to pay only on those actually returned. Business reply cards via air mail cost only 1 cent more than the usual air-mail fee. That may give you results of tests very quickly

Demurrage charges on c.o.d. mail can be avoided by using address labels recommended by the post office, giving specific instructions if undelivered

Letters, cards, and order forms can be mailed very cheaply. Check with the post office if you are mailing books or catalogues

Your covering invoice, if it applies strictly to the package contents can be enclosed in the package. That saves postage and the time of preparation that would be required if the invoice were mailed first class later

Each letter should carry the correct amount of postage. Buy stamps in various denominations, according to your mailing needs, to facilitate correct and quicker stamping

Self-mailers should be folded so that the entire inner surfaces of the piece may be inspected without breaking the seal. Use a metal staple or a stitch as preferred—it can be taken apart and put back

If you can use it, bulk mail is a great economy

The post office will check your mailing list and get new addresses—they do this cheaply

Special delivery should not be confused with special handling—special handling gets extra speed in handling only to the post office addressed; special delivery gets this, plus a special messenger for delivery at its destination. Don't use both

Are you getting the greatest return on your office employee budget?

Should you be running your own service departments? Check carefully present costs of your multigraphing, mimeographing, and mailing-machine operations, and other service units, against the cost of buying the work from an outside job shop.

When you do, be realistic. Too often your people will fight a change and be slipshod in their comparative data.

Every once in a while, analyze the jobs in your office. Find out if every one is essential to your profits. See if each job is being performed in the one best way. Here is a guide to check waste motions and duplicated efforts:

Is there a specific and understood purpose for each step or operation?

Does work move in a direct manner from one person to another without unnecessary repetition, duplication, or delays?

Is each step or operation performed in the same manner by all workers?

Do certain details or certain records require more time than the results are worth?

Are workers supplied with the necessary materials to perform the step or operation without unnecessary delays to get material?

How do your people work? Can you eliminate unnecessary interruptions; arguments and gossiping; absences from desks; delays in answering questions; procrastination; unnecessary questions?

Have an understudy for every job in an office. You waste a considerable amount of time in selecting and training outsiders for an exact operation that someone in your office can be watching and learning. New people always cause wear and tear and repairs. Inexperienced help always produces imperfect work and greater costs. Your own people will approve being made understudies for the more important vacancies. It gives them confidence in you.

Help your people do their work. Avoid the need for their wandering to deliver messages. Keep a three-tiered basket on each desk, for incoming, outgoing, and file papers. Insist upon written messages to avoid misunderstandings. Concise interoffice memos save time, minimize misunderstandings, and serve as reminders. A spoken message is often forgotten or misunderstood and usually requires much moving around the office, wasting time, and distracting others.

Watch your costs for supplies—they can be a source of great savings

In the use of carbon paper, cut off good marginal area of worn-out carbon paper for use with smaller forms. And adopt these cost-saving points:

Use an extra sheet of backing in your typewriter when carbon sheet grows dim

Reuse one-time carbon paper where suitable
Handle carbon paper carefully to avoid wrinkling and tearing
Limit the amount issued from the stock room
Make sure carbon paper is turned frequently to utilize entire surface
Place used carbon for first copy and new carbon for successive copies where multiple copies are required
Have all carbon turned in to a central place for examination before it is thrown away
Consider using 8½- by 8½-inch carbon paper instead of the usual size. It is often adequate
Use other duplicating methods to save carbon paper

Watch the use of typewriter ribbons. Here are some pointers:

Buy red-black ribbons only when you actually use the red
Invert your all-black ribbon when the lower side is worn dim
Reink typewriter ribbons for longer use
Wind ribbon onto one spool each night before leaving
Be sure ribbon feed is properly adjusted to ensure even wear

Watch the use of paper. Use both sides of file or index cards. Cross out the "dead" side. Cut old circular letters, reports, etc., and make them into pads. Do the same with old letters. And consider these aids:

Be sure stenographers use every line of their notebooks
Select the most economical grade and size of paper for each purpose
  Use paper of lighter weight
  Use smaller sized stationery for short letters
Economize on stationery by single spacing and reducing margins
Do not use envelopes for interoffice mail. Confidential letters may be sealed with a strip of paper
Make full use of the chain envelopes—one envelope that is arranged to be used a great many times by a printed form on its face
Where possible, use postal cards instead of letters
Retain obsolete forms and spoiled paper for scratch paper
Use both sides of the paper rolls in your adding machines
Single space on adding-machine tape, and use narrowest width possible
Discontinue writing unnecessary letters of transmittal and acknowledgment
Consider using the back of incoming letters for the first copy of your reply
If letters or reports will probably be corrected, make a rough draft, on cheaper paper, first
Use soiled or damaged company envelopes, when envelopes are necessary, for interoffice correspondence
Use longer sheets for mimeographed work instead of two. This also saves staples and decreases the cost of cutting, packaging, etc.
Use both sides of mimeograph paper

Use photostat to save time in typing, and eliminate possibility of error; it is sometimes cheap
See that only the needed number of mimeographed copies are ordered
Cut out unnecessary reports. They waste paper. Perhaps you can: prepare other reports less frequently; cut down the number of file copies
Make the best use of your wastepaper. Collect and sort it systematically. Then bale it and sell or shred it. But save all cardboard to use for packing or backing

Watch the use of other supplies. Save clips, pins, etc., on material to be thrown away. Don't use two clips or staples where one will do the job. Fasten papers together with sewing machine or use paper fasteners to save paper clips.

In using normal safeguards to avoid waste of supplies, go over all your forms to see what can be eliminated to cut down costs. Check every possible way of eliminating losses of supplies. Clean out all desks at definite intervals and return unneeded materials to stock room. Consider this:

Teach your people to use office supplies as sparingly as if they personally were paying for them
Check to see if you are discarding any material that can be reused
Recognize that waste in supplies can be due to mere lack of control; your system of delivering necessities to office people must be kept under control
Remember that waste often comes in spoilage of supplies. Find out whether work is intelligently or incompetently planned; instructions are definite—not ambiguous
Avoid serious waste in deterioration or obsolescence of supplies. Check your whole system of ordering and usage with this in mind
Issue supplies in limited quantities to each desk to reduce spoilage and waste

Check list for economical use of utilities

Your electricity bills should be watched. Instruct your employees on ways of conserving light and electricity. Place reminding notices at strategic places. Check and see that the conservation policy is followed this way:

Check the lighting system with light meters to be sure that there is no excessive disbursement for electricity
See that your people turn off lights and electrically driven machines when leaving desks—at noon, at rest periods, at closing time
Disconnect water coolers at night
Cut light costs by having ceilings and walls painted a light color and kept clean so that there is the maximum of reflection
Rearrangement of the office may secure more advantageous use of light and cut costs

Watch your telephone and telegraph costs. Be sure your staff understands telegraph rates. Have them use day letters and overnight letters where that is possible. Check occasionally to see whether air mail will not do just as well as telegrams. Study these points:

Consider instructions that will give exact instructions as to use of telegrams
Review telegrams occasionally so as to be able to discuss wastage with employees
Possibly approve telegrams before they are sent in order to find out if they are necessary
Find out if the people in your office are making too many personal telephone calls. If they are, make a charge for them
Make sure your office understands the cost of personal long-distance calls; possibly give them the cost at the end of their calls
Possibly install pay telephones so as to cut down on personal calls
Be sure to reconcile your telephone bills monthly with your operator's records
If you do much telegraphing across country, see that a schedule of differences in time is provided. The office you are trying to wire to by fast message (most expensive) may be closed
For frequent and lengthy communications that are unavoidable, consider timed wire messages or teletypewriter service, private or exchange

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